Trusting in trust - the role of trust law in the regulatory scheme applied to superannuation in Australia

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Trusting in Trust

The role of trust law in the regulatory scheme applied to superannuation in Australia

by

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School of Law
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Abstract:

Trust law plays an integral role in the regulatory scheme that shapes the superannuation system in Australia. The role is however more nuanced and complex than is typically appreciated. This Thesis examines relevant case law and statute and engages with both doctrinal and theoretical approaches to evaluate that role across two dimensions; the substantive and the instrumental. The substantive dimension refers to the contribution made by trust law to the substantive content of the regulatory scheme, and in particular the allocation of accountability and risk across participants in the system. The instrumental dimension refers to the various ways in which trust law's substantivity is injected into the regulatory scheme. The four modalities by which this occurs are described as an infrastructure role, an interpretive role, a default role and a normative role. The Thesis thus provides not only a more highly-developed description of the regulatory scheme shaping the superannuation system in Australia than has hitherto been articulated, it also provides an illustration of the complex inter-legality between the different sources of law in a modern regulatory state.

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Abstract

Trust law plays an integral role in the regulatory scheme that shapes the superannuation system in Australia. The role is however more nuanced and complex than is typically appreciated. This Thesis evaluates that role across two dimensions; the substantive and the instrumental.

The substantive dimension refers to the contribution made by trust law to the substantive content of the regulatory scheme, and in particular the way in which trust law influences the allocation of accountability and risk across participants in the system. This in turn promotes, in certain respects, the achievement of the two over-arching objectives of the regulatory scheme: economic efficiency and member protection.

The instrumental dimension refers to the various ways in which trust law's substantivity is injected into the regulatory scheme. The four modalities by which this occurs are described as an infrastructure role, an interpretive role, a default role and a normative role.

The Thesis thus provides not only a more highly-developed description of the regulatory scheme shaping the superannuation system in Australia than has hitherto been articulated, it also provides an illustration of the complex relationship between the different sources of law in a modern regulatory state.

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Introduction

Australia's superannuation system is a creature of public policy. It exists to provide a means by which individuals can save during their working lives to accumulate assets that can fund their retirement. However the system has no 'natural' existence. It is sustained by a combination of mandated contributions (the so-called Superannuation Guarantee) and tax concessions and hence it relies on governmental fiat for its continued existence.

A complex regulatory scheme governs, and indeed shapes, the superannuation system. Much of that scheme remains in the private sphere. Trust law, in particular, plays an important role in locating and defining property and other rights across the system. To this successive governments have added statutory measures designed to buttress, adjust or eclipse those rights. Those interventions respond to two overarching regulatory objectives: economic efficiency and member protection. The result is a complex tapestry of rules deriving from different juridical sources. The interplay and interdependence of these rules are a vibrant example of what de Sousa Santos has termed 'inter-legality.'[1] This Thesis examines and illustrates that inter-legality in the course of mapping and analysing trust law's contribution to the regulatory scheme.

1 Boaventura de Sousa Santos, *Toward a New Legal Common Sense: Law, Globalization, and Emancipation*, (2nd ed, Cambridge University Press, 2002)

The Role of Trust Law

Trust law provides an important juridical cornerstone for the operation of the superannuation system. As we shall see, it operates alongside and in conjunction with contract, statute and regulatory rule. It provides the legal infrastructure for most superannuation funds and it provides the regulatory scheme with a point on which to focus regulatory attention. As the Commonwealth Treasurer of the day noted when introducing the legislation that forms the backbone of the statutory scheme:

> 'prime responsibility for the viability and prudent operation of the superannuation industry rests with trustees'[2]

That much is well understood. However this Thesis argues that trust law's contribution to the regulatory scheme applied to the superannuation system in Australia goes much deeper than is typically recognised. Trust law is an integral part of the regulatory scheme and makes a contribution that is contingent, conditional and nuanced.

The analysis in this Thesis maps and assesses that contribution across two dimensions: the substantive and the instrumental.

The substantive dimension considers the contribution made by trust law in determining who bears the consequences in any particular set of circumstances for the realisation of an undesirable outcome, such as a poor investment return or a loss caused by fraud. The substance of trust law, the circumstances in which it locates accountability with the trustee and the circumstances when it does not, contributes to a regulatory scheme that gives effect to a conditional matrix of accountabilities. As an example, from this perspective the familiar trustee duties to act honestly, carefully and diligently[3] function within the regulatory scheme to influence whether or not the incidence of a loss should be borne by the trustee or by the beneficiary (or potentially some other third party). They provide criteria by which that allocation will be determined.

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2 See for instance John Dawkins, Treasurer of the Commonwealth of Australia, *Strengthening Super Security. New Prudential Arrangements for Superannuation* (AGPS, 1992), 3.

3 These duties, and the case authority that elucidates them, are considered in detail in Chapter 5.

The substance of trust law is undoubtedly one of the reasons that policy makers were attracted to selecting trusts as the preferred legal infrastructure for the superannuation system.[4] There are clear resonances between trust law's intense concern for the interests of beneficiaries and policy makers' expressed desire to secure protection for fund members. However, as we shall see, member protection is only one of the regulatory objectives expressed by policy makers and there are circumstances where the pursuit of the objective of member protection has to be tempered by, for instance, the pursuit of economic efficiency.

Equally, it would be a mistake to assume that trust law is monotonically member-protecting. Trust law certainly does evince a concern with the interests of beneficiaries, but as the analysis in Chapters 4 to 8 demonstrates, the protection it offers to the members of a superannuation fund is far more nuanced than the rhetoric of trust law implies. Moreover, trust law's substantive contribution is subject to contractual or statutory circumscription, and in some circumstances eclipse. It is not possible therefore to summarise the substantive contribution made by trust law to the regulatory scheme in a few words. Analysis must proceed by reference to specific circumstances which capture the nuances and complexities arising from the interaction between the trust law principles and the other sources of rules with which they are integrated. Specific practical examples are therefore presented throughout the analysis in this Thesis to illustrate and instantiate trust law's substantive contribution.

The second of the dimensions, the instrumental dimension, identifies the various ways in which the substance of trust law is injected into the regulatory scheme. This dimension is distilled into four related but conceptually differentiable modalities; an infrastructure role, an interpretive role, a default role and a normative role. The first three of these modalities operate within the formal parts of the legal system, guiding the deliberations of the courts, tribunals and regulators in the matters that arise for their consideration. The latter, the normative role, is slightly different. It is concerned with the way in which the distinctive

[4] This is discussed in detail in Chapter 4.

language of trust law, and the elements of equitable doctrine on which it is based, inspires expectations and norms of behaviour that together contribute to the creation of a culture of superannuation fund trusteeship.

The analysis presented in Chapters 4 to 7 highlights that trust law has features that enhance its ability to contribute in each of these ways as well as features that undermine or limit its effectiveness. Many of these features derive from trust law's private law genesis. This genesis ensures that trust law retains a flexibility to accommodate change and diversity; vital attributes in a system such as the superannuation system. At the same time, that genesis renders trust law vulnerable from a regulatory perspective where there are imbalances in private negotiating power, such that some individuals are unable to safeguard their own interests, or where the interests of neither party are aligned with regulatory priorities. In those circumstances some form of legislative or regulatory intervention is typically required.

The conclusion therefore reached in this Thesis to the question 'What contribution does trust law make to the regulatory scheme shaping superannuation?' is thus that trust law makes an important contribution to the regulatory scheme shaping superannuation.

Trust law provides the legal infrastructure for the key institution responsible for the administration of the system, the superannuation fund. In addition, it influences the substance of the regulatory scheme in three other, less obvious ways. It is available to assist in the interpretation of key statutory provisions. It is also a source of default rules where the statutory regime is silent or deficient. Finally, its exhortative character inspires normative compliance on the part of trustees that promotes an overarching regulatory concern for member protection. Trust law is thus integrally intertwined from an instrumental perspective in the inter-legal regulatory tapestry governing the superannuation system.

The inter-legality has a substantive dimension also. Trust law plays a crucial role, in conjunction with statute and contract, in effecting a nuanced and conditional distribution of accountability across participants in the system. That substantive contribution in some ways promotes, and in other ways merely accommodates, the achievement of the two overarching objectives expressed for the regulatory scheme: economic efficiency and member protection.

Structure of the Thesis

Chapter 1 contains a description of the superannuation system, including its main participants and regulatory architecture. It also identifies the pivotal role played by the trustee in the superannuation system.

Chapter 2 describes the regulatory scheme that governs, and in many ways shapes, the superannuation system. It introduces the concept of 'inter-legality,' one of the key themes in this Thesis. It also counters the suggestion that superannuation funds ought to be considered as a novel form of trust to which ordinary trust principles should not apply. It then provides an overview of the key statutory elements of the regulatory scheme and identifies the two regulatory objectives animating the regulatory scheme: economic efficiency and member protection. Finally, it briefly outlines the private and public modes of enforcement available to remediate losses and promote compliance.

Chapter 3 describes the role played by trust law in the regulatory system as a precursor to the more detailed analysis presented in Chapters 4 to 8. It argues that trust law's contribution can be viewed across two dimensions; the substantive and the instrumental. This distinction is valuable because it provides a framework for analysis that assists in the elucidation of some complicated and, at times, subtle ideas.

The substantive dimension considers the impact that trust law has on the key question: 'who bears the consequences for the realisation of an undesirable outcome?' The answer is conditional (in the sense that it depends crucially on the circumstances) and contingent (in that trust law is only one of a number of sources of rules that together may govern the situation). What emerges from that conditionality and contingency is a 'matrix of accountabilities' that defines where and when accountability is located and relocated across the institution that is the superannuation fund.

The instrumental dimension captures the ways in which trust law makes that substantive contribution. It finds that the instrumental dimension played by trust law has four distinct modalities:

1. It provides a convenient legal superstructure to give effect to the activity known as superannuation.

2. It informs the statutory framework imposed on the superannuation system, providing a jurisprudential foundation for key provisions in the *SIS Act* in particular.

3. It provides a default source of rules, providing content where the formal sources of law (statute and contract) are deficient or silent.

4. The colourful rhetoric employed by the courts in articulating equitable (and particularly fiduciary) doctrine contributes a vocabulary to discourse in the superannuation arena that is intended to inspire expectations and behaviours that go beyond the strict letter of the law.

The distillation of the instrumental dimension into those four modalities supplies the structure for Chapters 4 to 7.

Chapter 4 identifies the role played by trust law in providing a blue-print for the legal infrastructure of the system. It emphasises the importance of the fact that trust law focuses responsibility for administration of the trust on the office of trustee. The trustee is responsible both in the sense of having unparalleled authority and also stringent accountability should there be deficiencies of specific types in the administration of the trust.

The Chapter goes on to recognise that trust law's substantive contribution is undermined by two factors related to this infrastructure role. The first is the risk of opportunistic contractual eclipse. The second is the requirement that superannuation trustees be corporate entities which is a consequence of the distribution of legislative powers effected by the Australian Constitution. This requirement complicates the matrix of accountability, especially in regards to issues such as conflicts of interest, by introducing an additional layer into the governance of superannuation trusteeship. It also renders ambiguous some of the standards, including the standards of care and diligence, expected of key participants in the system.

Chapter 5 illustrates the way in which trust law's substantive content is injected into the statutory regime directly when concepts and a vocabulary drawn from trust law are employed in that scheme. It recognises that there are risks with this approach where the precise meaning of the phrases employed from trust law is unclear or ambiguous. However it also recognises that harnessing Equity's principle-based approach endows the key statutory provisions with an ability to evolve and adapt flexibly in response to changing circumstances.

The Chapter then describes in detail three examples where statutory provisions invoke trust law concepts directly:

- **Part 5.3** analyses the reference to 'care, skill and diligence' and to 'prudence' in s 52(2)(b). It finds that the open-textured nature of the relevant general law provides a suitable framework for applying these concepts in a contemporary setting. It does however note that the specification of the standard to be applied as that of the 'ordinary prudent person' differs from that present in trust law generally.
- **Part 5.4** analyses the reference to 'best interests' in s 52(2)(c). It finds that though the genesis of the 'duty' to act in the best interests of beneficiaries is unclear, an expansive definition of the duty to accommodate a wide range of familiar equitable duties (and in particular 'loyalty', 'fidelity' and 'impartiality') is consistent with the substance of trust law and results in an interpretation of s 52(2)(c) that is useful in a variety of practical settings.
- **Part 5.5** analyses the reference to 'sole purpose' in s 62 of the *SIS Act*. It finds that ambiguity lurks behind the apparent simplicity of the provision. Nevertheless recourse to general law principles can assist in deriving an interpretation that is consistent with the primary purpose of the superannuation system and provides clarity for participants.

Chapter 5 thus identifies that reference to familiar trust law 'terms of art' does not necessarily endow the provisions with an unambiguous and universally-accepted meaning. Challenges of interpretation remain. However in each instance it concludes that overall the drafting strategy is effective in incorporating the substance of trust law into the statutory framework in a way that both is sufficiently flexible to promote the regulatory objectives described in Chapter 2 and yet promotes certainty.

Chapter 6 examines the ability of trust law to act as a source of default rules for the regulatory scheme where the statutory regime and the terms of the trust instrument are silent or deficient. It finds that the cognitive structure of trust law, its reliance on 'principles' rather than 'rules', is very valuable in this regard. The reliance on principles means that the equitable doctrine on which trust law is based can be applied to diverse circumstances, a vital characteristic in a system that is both highly diverse and capable of rapid, unanticipated innovation and evolution. However it also recognises that the same attribute exposes equitable doctrine to criticism for lack of specificity.

Chapter 7 examines the fourth element of the instrumental role played by trust law; the normative role. It investigates the possibility that trust law's influence extends beyond the formal reach of the legal system, permeating the consciousness of participants in the system and thereby creating norms that influence their behaviour. It finds that the context of 'trusteeship' exerts a strong influence on the way that individuals perceive their role, and on the seriousness with which they view their statutory obligations. Together with the exhortative rhetoric in which trust law is often presented, this has helped to create a set of norms that inspire individuals to provide a quality of service to the administration of the trust that operates outside the formal processes of the law.

Chapter 8 returns to the regulatory objectives identified in Chapter 2. It first notes that the regulatory objectives not only guide policy makers, they also provide criteria for assessing the substantive contribution of trust law to the regulatory scheme.

The Chapter next evaluates the role of trust law with respect to economic efficiency, concluding that although trust law does not specifically promote economic efficiency, it does possess attributes that neo-classical economic theory would suggest are supportive of economic efficiency. Most importantly, trust law is capable of accommodating private market modalities which discipline the processes and institutional structures that constitute the superannuation system and impel the system towards economic efficiency.

In contrast, the Chapter concludes that trust law does contribute directly to the calibration of the regulatory scheme in respect of the member protection objective, but perhaps not in the way sometimes simplistically assumed. Specifically, by according recognition to certain causes of action and by privileging certain decision criteria, trust law helps to bring about an allocation of accountability between the actors in the system. This allocation of accountability is the essence of member protection. However the analysis also concludes that the paternalism that permeates much of trust law is not unequivocally member protecting. Indeed beneficiaries of trusts, and members specifically in the context of superannuation funds, have to rely heavily on the normativity of trust law because in many cases the emaciated mechanisms for monitoring and enforcement within trust law undermine the intensity of accountability that can be expected from formal legal modalities. Members and policy-makers must therefore, to some extent at least, 'trust in trust.'

The **Conclusion** draws together the analysis in Chapters 2 to 8, distilling the main themes presented in those chapters. It concludes that notwithstanding the shortcomings identified by the analysis presented in earlier chapters, trust law plays an integral and valuable role in the regulatory scheme applied to the superannuation system, one that would be difficult to replicate from other sources.

Relevance and Contribution

This Thesis maps and analyses the role played by trust law in the regulatory scheme shaping superannuation. It does so in order to highlight:

- The crucial multi-faceted role played by trust law in the regulatory scheme;
- The relationship between the substantive content of trust law and the regulatory concerns animating the regulatory scheme applied to the superannuation system;
- The challenges to trust law posed by organic developments within the superannuation system; and
- The aspects of trust law that require statutory support.

Why is this important? It is important because of the span of the superannuation system. The advent of compulsory superannuation has enrolled the overwhelming majority of adult Australians in the system. This in turn has resulted in the accumulation of unprecedented assets in superannuation funds under the control of private sector entities serving as trustees across the country, assets which are not only crucial for the retirement plans of millions of Australian workers but also for the efficient operation of Australian capital markets.

It is surprising therefore that little academic work has been done assessing the role of trust law in superannuation. As we shall see, attention has until now been largely focused on narrow issues (such as the scope of curial review of trustees' decisions and the rules applying to investment of superannuation fund assets). In analysing the contribution of trust law from a broader perspective, this Thesis aims therefore to provide a more comprehensive picture of the role played by trust law, and the consequences that flow from that role, than is present in the academic literature today.

There are areas in this Thesis where the analysis is directed towards specific jurisprudential controversies. Though the resolution of such controversies is not a primary objective of this Thesis, a number of articles focusing on those controversies, and based on the analysis underlying this Thesis, have already been published in peer-reviewed journals:

'Does "sustainable" investing compromise the investment obligations owed by super fund trustees?' (2008) 36 *Australian Business Law Review* 47 (with N. Taylor)

'The prudent eunuch: Superannuation trusteeship and member investment choice' (2008) 19 *Journal of Banking and Finance Law and Practice* 5

'"Best" interests?' (2008) 2(3) *Journal of Equity* 245

'The competence and diligence required of trustees of a 21st century superannuation fund' (2009) 37 *Australian Business Law Review* 50

'All Aboard the PDS Titanic' *Jassa*, Autumn 2009

'Prudence Under Pressure' (2010) 4 *Journal of Equity* 44

'What's in a Name? Examining the Consequences of Inter-legality in the Superannuation context' (2011) 33 *Sydney Law Review* 295

Sources

This Thesis relies on research conducted across a wide range of sources and disciplines. Detailed doctrinal analysis using case law and statute has been undertaken to define carefully the law relevant to the phenomena under consideration. This Thesis makes no claim to comparative analysis of other jurisdictions, nor analogous phenomena. Therefore, for the most part, the case law is that of Australia, with reference to English cases where required. One result of this is that in some areas, at least, there is little detailed case law upon which to base analysis. As we shall see however, this lack of case law specific to the superannuation context is one of the reasons why trust law's multi-faceted role is so important. Trust law can supply substantive content to guide the interpretation of statutory provisions and to address lacunae in the regulatory scheme when there is little or no specific curial consideration of the issue arising. The law is stated as at 30 June 2012.

Simple empirical analysis is also presented, mostly in Chapter 1. This is supplemented by references to secondary research, including references to news media and industry sources where relevant. These sources help to frame the legal issues in their practical context and highlight the complexity and dynamism of the phenomenon under investigation.

The Thesis also engages with relevant regulatory, jurisprudential, sociological and economic theory. Most important amongst these is the notion of 'inter-legality' derived from de Sousa Santos,[5] which is used as a way to describe the multi-faceted relationship between trust law and other strands of the regulatory scheme. The analysis below also employs notions from systems theory to characterise the role and operation of the regulatory scheme and from neo-classical economics to evaluate trust law's contribution to the pursuit of economic efficiency. One consequence of this multi-disciplinary approach is that the analysis touches on a number of debates in the academic realm that, although important in other contexts, are tangential to the propositions advanced in this Thesis. Recent contributions to those debates are referenced in footnotes.

[5] See above n 1.

All sources are cited where relevant in footnotes to the text. The Australian Guide to Legal Citation has been applied to most references. Abbreviated references are however used for a small number of seminal reports into the superannuation system, reference to which recurs frequently in the analysis and argument in the Thesis. They appear in the table below.

Frequently cited sources and the abbreviations applied	
Australian Law Reform Commission, *Collective Investments: Superannuation*, Report No 59 (1992)	Law Reform Commission, *Superannuation* (1992)
John Dawkins, Treasurer of the Commonwealth of Australia, *Security in Retirement. Planning for Tomorrow* (AGPS, 1992)	Dawkins, *Security in Retirement* (1992)
John Dawkins, Treasurer of the Commonwealth of Australia, *Strengthening Super Security. New Prudential Arrangements for Superannuation* (AGPS, 1992)	Dawkins, *Strengthening Super Security* (1992)
Productivity Commission, *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, Inquiry Report No 18 (2001)	Productivity Commission, *Review of the Superannuation Industry* (2001)
Super System Review, Review into the Governance, Efficiency, Operation and Structure of the Superannuation System, including: *Clearer Super Choices: Matching Governance Solutions*, *Preliminary Report of the Super System Review* (December 2009) *MySuper: Optimising Australian superannuation* (April 2010) *Final Report - Part One: Overview and Recommendations* (July 2010) *Final Report - Part Two: Recommendation Packages* (July 2010)	 Cooper Review, *Preliminary Report* Cooper Review, *MySuper* Cooper Review, *Final Report: Part One* Cooper Review, *Final Report: Part Two*

Chapter 1

Introduction to the Superannuation System

'No investment is more special than superannuation. No investment is more critical in providing retirement income for an increasingly ageing population. The security of superannuation is most important to all Australians'

The Honourable John Dawkins, MP[1]

This Chapter describes Australia's superannuation system and its key constituent parts. It introduces the main elements of the system as a background for the analysis presented in later chapters. In so doing, it highlights that the system is diverse, complex and dynamic. The regulatory scheme, and by extension this Thesis, must accommodate and engage with that complexity.

Part 1.1 outlines the public policy background to the superannuation system.

Part 1.2 then describes the two main types of superannuation benefit administered by superannuation funds. Trust law's ability to accommodate such diversity is a recurrent theme in this Thesis.

Part 1.3 then introduces the idea that the collective activity identified as 'superannuation' is more than simply a market or an industry, but rather is best considered as a system. That perspective positions the regulatory scheme under consideration in this Thesis as an integral constitutive part of that collective activity.

Part 1.4 briefly describes the different operating or business models pursued by superannuation funds. The diversity mapped in this Part arises partly from, and in turn influences, the regulatory scheme. This reflexivity between the regulatory scheme and the regulated population is another recurrent theme in this Thesis.

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1 Dawkins, *Strengthening Super Security* (1992), iii.

Part 1.5 concludes this introductory Chapter by describing the role played by the various participants in the superannuation system and, in particular, the pivotal role played by the trustee in administering the ‘virtual’ institution that is the modern superannuation fund.

1.1 Australia's compulsory superannuation system

Australia's superannuation system owes its current prominence to a continuous seam of government policy stretching back over two decades and 8 parliaments. From the introduction of the Superannuation Guarantee in 1992 until the present day there has been bi-partisan support in parliament for a system of compulsory saving for retirement. This support has, to date, seen over $1.3tr accumulated in investment vehicles known as superannuation funds.[2] Of this $1,335bn, approximately $890bn[3] is administered within co-mingled, intermediated vehicles for which trust law provides the basic infrastructure.[4] Were the government's support for the superannuation system to be withdrawn (for example by removal of the tax concessions applying to superannuation or termination of the Superannuation Guarantee), the superannuation system would almost certainly wither.[5] A clear understanding of the policy objectives underlying governmental support is thus a vital starting point from which to embark on any assessment of the system, the regulatory scheme to which it is subjected, and the role of trust law in that regulatory scheme.

The purpose of Australia's superannuation system

The term 'superannuation' is applied in Australia to the accumulation of private saving to fund retirement spending. Almost all OECD countries have an equivalent

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2 APRA, *Annual Statistical Bulletin (2011),* 34.

3 APRA, above n 2, 34.

4 Much of the remainder is invested in so-called Self-Managed Superannuation Funds ('SMSFs') in which the members act as their own trustees. SMSFs fall outside the ambit of this Thesis.

5 The recent history of superannuation in New Zealand illustrates this compellingly. See Susan St John, 'Pension Provision in New Zealand', in Richard Disney and Paul Johnson (ed), *Pensions Systems and Retirement Incomes across OECD Countries*, (Edward Elgar, 2001); David Thomson, 'The Future of New Zealand's National Superannuation' (1996) 3 *Agenda* 297.

system,[6] although in most countries the phenomenon is called the private 'pension' system.[7]

Modigliani and Muralidhar define the 'primary purpose' of a pension system as:

> to help households achieve an allocation of life resources by smoothing consumption over life ... That is achieved by transferring resources from working life to post-retirement, when income dries up.[8]

This can be paraphrased and adapted to the Australian context as; *to provide a means by which individuals will save during their working (earning) lives to accumulate assets that can fund some, or all, of their expenditure in retirement.*

Defining the functional purpose of the system is however not the same thing as identifying why it is that successive governments have maintained support for the superannuation system.

The view traditionally taken by economists, influenced particularly by Diamond[9] and Feldstein,[10] is that government intervention in the process of saving for retirement is founded on individual 'myopia'; a failure on the part of individuals to save for their own retirement. Drew and Stanford[11] and Bateman and Piggott[12] apply that approach in respect of the Australian system.

6 This is also the English-language term employed by the OECD to refer to the phenomenon; OECD, *Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries* (OECD, March 2011).

7 Although there are a number of features of Australia's system that, if not unique, are at least consequentially distinct, treating these terms as synonymous is unlikely to lead to any misapprehension in the context of this Thesis.

8 Franco Modigliani and Arun Muralidhar, *Rethinking Pension Reform* (CUP, 2004), 1.

9 Peter Diamond, 'A framework for social security analysis' (1977) 8 *Journal of Public Economics* 275, 281

10 Martin Feldstein, 'The optimal level of social security benefits' (1985) 100(2) *Quarterly Journal of Economics* 303.

11 Michael Drew and Jon Stanford, 'Why is Superannuation compulsory' (2004) 37(2) *Australian Economic Review* 184.

12 Hazel Bateman and John Piggott, 'Private Pensions in OECD Countries – Australia', in OECD, *Labour Market and Social Policy Occasional Paper - No 23* (OECD, 1997), 59.

This Thesis takes a different approach. It draws inspiration from the policy pronouncements of successive governments to recognise expressly the role of broader policy objectives in both securing ongoing government support for the system and inspiring regulatory intervention. It does so while still emphasising the important role played by private market participants and forces within the system for, as one of its primary architects recently remarked,

> The essence of this scheme is that it is government sponsored but privately managed.[13]

The result is a more nuanced and empirically faithful account of the internal workings of the system and its components than issues from the standard economic model.

Compulsion and the Superannuation Guarantee

Australia's superannuation system can be traced back to the late nineteenth century.[14] However the introduction of the Superannuation Guarantee in 1992[15] was a watershed in its history.[16] Prior to 1992 employers were under no obligation to provide superannuation to their employees. Those that did, did so under the employment contract entered into with their workforce either collectively or

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13 The Hon. Paul Keating, reported in Nick Coates and Sasha Vidler, 'Superannuation Policy. Commentary on an Interview with Paul Keating, former Prime Minister' (2004) 53 *Journal of Political Economy* 9, 12.

14 Commonwealth Treasury, 'Towards higher retirement incomes for Australians: a history of the Australian retirement income system since Federation' [2001] *Economic Roundup* 65; Productivity Commission, *Review of the Superannuation Industry* (2001), [2.1].

15 *Superannuation Guarantee Administration Act 1992* (Cth). Though the process started with the decision of the Industrial Relations Commission in the National Wage case in 1986 to divert award wage increases consequent upon productivity increases into superannuation, it was the Superannuation Guarantee in 1992 that raised it to a 'universal' system.

16 This was not the first time that compulsory superannuation had been considered in Australia. Proposals for universal contributory superannuation had been considered and rejected by the government in 1928, 1938 and 1976. Commonwealth Treasury, above n 14, 75.

individually. In most cases it was available only to senior (mostly male)[17] executives and public servants. As a result it was seen as the preserve of a privileged section of the community and barely registered in public policy thinking.[18] Government support for superannuation was largely limited to the provision of tax incentives for employers and members. Regulatory controls were primitive.[19]

The Superannuation Guarantee requires employers to pay contributions calculated by reference to an employee's salary/wage[20] into a complying superannuation fund of the employee's choice.[21] It is not possible to 'opt-out' of the system. As a result, over 89% of the workforce is now covered by the superannuation system,[22] approximately 11.6 million individuals.[23]

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17 This factor appears to have been particularly important in the early stages of the policy cycle leading to the introduction of the SG in 1992. The emphasis on gender inequality in the Cass Report and by Howe was far greater than that of Dawkins just three years later; Department of Social Security, *Towards a National Retirement Incomes Policy, Social Security Review Issues Paper No 6* (1988), (the 'Cass Report'); Brian Howe, Minister of Social Security, *Better Incomes: Retirement Income Policy into the Next Century* (AGPS, 1989); Dawkins, *Security in Retirement* (1992).

18 Allan Borowski, 'The revolution that faltered: Two decades of reform of Australia's retirement income system' (2005) 58(4) *International Social Security Review* 45.

19 They included limits on repatriation of fund assets to employers and (until 1984-5) the 30/20 rule which required superannuation and insurance funds to maintain portfolios containing 30% public securities of which two-thirds had to be Commonwealth government bonds. Somewhat belatedly, reg 13 of the *Occupational Superannuation Standards Regulations,* made under the *Superannuation Entities (Taxation) Act 1987,* imposed prudential limits on lending to members and the purchase of in-house assets that were the precursor to the measures present in the current regulatory scheme.

20 Currently; s 19 of *Superannuation Guarantee (Administration) Act 1992* (Cth) sets this as 9% of ordinary time earnings, though the legislation passed since 31 December 2011 will see this increase progressively to 12% over the coming six years. For more details on how this amount is calculated in practice, see www.ato.gov.au.

21 Where no express choice is made, the employee's contribution is made to a 'default' fund selected by the employer.

22 Australian Taxation Office, *Taxation Statistics 2008-09: Superannuation System* (2009).

23 Australian Bureau of Statistics, 2007, *Employment Arrangements, Retirement and Superannuation*, Cat No 6361.0, ABS, Canberra.

The Superannuation Guarantee enrolled the superannuation system as one of the three 'Pillars'[24] of the government's retirement incomes policy. It ensured that policies regarding the superannuation system became a central component of government social and economic policy.[25] This means that superannuation, and the system in which it is administered, can now no longer be seen as residing purely in the realm of the employment relation; it now has a material 'public' element.[26]

A corollary of this was an intensification of the government's interest in regulating the superannuation system.[27] The Superannuation Guarantee dramatically increased the breadth of the impact of the superannuation system. Failures, inefficiencies and other shortcomings in the system would be felt by a much wider segment of the population and potentially have a far greater economic impact. The implications of this for the regulatory system are described below.

More subtly, though, the government's role in requiring and enforcing compulsion has affected its appetite for different types of risk. In particular it intensifies the political imperative on the government to ensure that any failures that do occur are contained at a local level. From the government's perspective they cannot be allowed to threaten the integrity of the system nor the confidence of participants within the system.[28] This makes the institution of the trust, which as we shall see in Chapter 4 locates accountability very clearly in the hands of private entities (the trustees of the funds), very attractive.[29] It also means that the regulatory scheme can tolerate low levels of local failure, so long as that does not escalate to a systemic level. As we shall see below this is an important consideration in the calibration of

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24 Cass Report, above n 17, 179.

25 Dawkins, *Security in Retirement* (1992), 1. Traces of this can be seen in Howe, above n 17.

26 *Finch v Telstra* [2010] HCA 36, [34].

27 Dawkins, *Strengthening Super Security* (1992), 3.

28 See for instance Minister's Introduction, in Superannuation Working Group, *Options for Improving the Safety of Superannuation, Issues Paper*, (2001), iii.

29 Bateman and Piggott, above n 12.

the regulatory scheme with respect to its two key objectives: member protection and economic efficiency.

The public policy objectives underpinning compulsory superannuation

Policy pronouncements over the past two decades contain a number of explanations for the sustained support provided by successive governments to the compulsory superannuation system brought about by the SG. The most important of these are intergenerational equity, social inclusion and nation building.

Intergenerational equity: addressing the 'baby-boomer' effect

Much of the political discourse surrounding the introduction of compulsory superannuation in 1992 was directed towards addressing the fear that demographic pressures on the public accounts would make continuation of the PAYG public welfare system (primarily the Age Pension) untenable in the decades beyond 2010. [30] This phenomenon was sometimes termed the 'baby-boomer'[31] effect, or more formally 'intergenerational equity'.[32]

This concern had been growing through the mid-1980s in public policy circles. It culminated in reports by Cass[33] and Fitzgerald[34] which recommended broadening of participation in superannuation and the introduction of a mandated minimum annual contribution. The Superannuation Guarantee transformed the funding

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30 Commonwealth of Australia, *Intergenerational Report (2002-3)*, Commonwealth Government Budget Paper No 5 (2002). Also Ian Robinson, 'Superannuation – A policy perspective' in Kevin Davis and Ian Harper (eds), *Superannuation and the Australian Financial System* (Allen and Unwin, 1992), 8.

31 See for instance Simon Kelly and Ann Harding 'Funding the Retirement of the Baby Boomers', (2004) 11(2) *Agenda* 99.

32 Janna Thompson, 'Intergenerational Equity in an Ageing Society' (2004) 11(4) *Agenda* 83; Mordecai Kurz, 'Social Policy Evaluation, Social Risk and Pension Capital' (2006) 3 *Rivista Internazionale di Scienza Sociali* 389.

33 Cass Report, above n 17, 163 – 176.

34 Vincent FitzGerald, *National Saving: A Report to the Treasurer* (AGPS, 1993).

arrangements from a Pay as you Go (PAYG) system to one where financial resources would be set aside along the way to help fund the expected future liability.[35]

Importantly, the Superannuation Guarantee meant that from 1993 retirees would be increasingly funding their own pre-retirement savings, rather than contributing collectively to a pool from which one day they might hope to draw retirement incomes. So for instance the Treasurer noted in passing when introducing the Superannuation Guarantee,

> the national interest in greater self-provision for retirement, and to the *individual interest in living better in retirement*, [36] (emphasis added)

However little was made of it. Such attention as was paid in the political rhetoric to the 'individualisation' inherent in superannuation was largely couched in terms of promoting private saving.[37] As we shall see, however, this systemic transfer of risk to individuals is very important in the context of this Thesis. The way in which trust law, as part of the regulatory scheme, conditions and distributes risk across participants in the system is central to understanding the contribution made by trust law to that scheme.

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35 That such a strategy is economically rational given the demographic trend forecast at that time flowed directly from the Aaron-Samuelson condition which holds that pre-funded systems such as the SG are rationally preferred to PAYG systems during periods of low wage growth and fertility and decreasing labour force participation: see Paul Samuelson, 'An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money' (1958) 66 *Journal of Political Economy* 467 and Henry Aaron, 'The Social Insurance Paradox' (1966) 32 *Canadian Journal of Economics and Political Science* 371. Also John Myles and Paul Pierson, 'The comparative political economy of pension reform' in Paul Pierson (ed) *The new politics of the welfare state* (OUP, 2001), 310. For a rare rebuttal of this argument based on classical economics, see Dick Bryan, 'Superannuation; the Ricardian Crisis' (2007) 53 *Journal of Australian Political Economy* 100.

36 Dawkins, *Security in Retirement* (1992), 17.

37 Malcolm Edey and John Simon, 'Australia's Retirement Income System' in Martin Feldstein (ed), *Privatizing Social Security* (University of Chicago Press, 1998), 68.

Promoting 'social inclusion'

At a very basic level, it is clear that the Superannuation Guarantee extended the participation in superannuation from the 'privileged' few to near-universal coverage of the workforce. The Australian Bureau of Statistics reports that in 1974, only 28% of civilians aged 15 or older had ever had superannuation coverage.[38] By November 1991 this had risen to approximately 60% (the figure was inevitably higher, at 78%, for those currently in employment).[39] Coverage was also skewed strongly in favour of male workers and against female workers.[40] As of 2007 the equivalent figures are 71% and 94% and the gender skew has narrowed.[41] On the surface, this is unequivocally 'inclusive.'

There is another sense in which the superannuation system might be said to be inclusive. This is the idea that the superannuation system gives individuals who are not traditionally a part of the 'investing class' participation in the process and proceeds of capital formation, a 'slice of the action' as it were. Some commentators take this a step further, identifying in universal superannuation the opportunity for individuals to engage across a broader front. Olsberg for instance argues:

> Political democracy seems to offer fewer and fewer opportunities for people's involvement ... The opportunity exists – through superannuation funds – for Australians to participate in the major economic decision-making which will determine the future of the country. It is an opportunity which must not be ignored. It is a real chance to extend economic democracy.[42]

The problem is that whilst this more ambitious vision of social inclusion may have been present in the rhetoric justifying compulsory superannuation, there are few, if

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38 Australian Bureau of Statistics, 2009, 'Trends in superannuation coverage' in *Australian Social Trends*, Cat No 4102.0, ABS, Canberra.

39 Ibid, 41.

40 Ibid, 42. See further Dimity Kingsford Smith, 'Superannuating the Second Sex; Law, Privatisation and Retirement Income' (2001) 64(4) *Modern Law Review* 519.

41 ABS, above n 38, 41.

42 Diana Olsberg, *Ageing and Money, Australia's Retirement Revolution* (Allen & Unwin, 1997).

any, mechanisms by which fund members can actually directly influence the 'major economic decision-making' in the manner anticipated by Olsberg.

There is also increasing recognition that social inclusion in the superannuation context extends beyond such issues as coverage and contribution rates[43] and that it ought also encompass the implications of alternative career-paths, tax progressivity and effective exclusion as a result financial illiteracy.[44] These issues lie outside the ambit of superannuation's regulatory system and hence are not directly addressed in this Thesis. However they are an important 'real-world' backdrop, the importance of which should not be underestimated.

Promoting 'nation-building'

The third of the objectives typically articulated for the superannuation system was 'nation-building'. The Foreword to *Security in Retirement*, the document launching the Superannuation Guarantee, concluded:

> Over the long term, [the SG] will also generate a larger pool of investible funds – Australian funds for investing for Australia. It will diminish our need for foreign borrowings and enhance Australia's capacity to develop industry and create employment.[45]

In more recent times this potential has, for instance, been articulated in terms of funding national infrastructure, such as roads, telecommunications and hospitals.[46]

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43 The progress made in Australia in this regard has moved the focus to the question of 'adequacy'; see for instance John Piggott and John Evans, 'SGL Adequacy & retirement: Longevity and Economic Impacts' (2007) *Jassa* 22 (August). However both issues remain alive in parts of Europe where third pillar provision is not mandatory and workforces contain proportionately more non-citizen participants; see for instance Traute Meyer, Paul Brigden and Barbara Riedmüller, *Private Pensions versus Social Inclusion. Non-State provision for Citizens at Risk in Europe* (Edward Elgar, 2007).

44 See for instance Julian Disney, 'Superannuation and Lifelong Saving' [2007] *UNSWLRS* 28.

45 Dawkins, *Security in Retirement* (1992), iii.

46 See for instance Leslie Neilson, 'Superannuation investment in infrastructure' (Parliamentary Library Research Note No. 42, 2005).

It has to be recognised however that nation-building is about more than simply the aggregate effect of accumulating of assets in anticipation of individual retirement needs; it is about what those assets are used for in the interim. Again the problem lies in identifying the impact of such aspirations in the design either of the system or in regulatory measures applied to the system. Indeed successive governments have expressly eschewed measures to so direct the capital contained in superannuation funds,[47] preferring at least publicly to allow market mechanisms to identify a market-clearing price for such assets. So though nation-building is undoubtedly a benefit that politicians and others would like to see accrue from the superannuation system, it is hard to identify concrete features of either the system or the regulatory scheme that pursue this objective directly.

The limits of the superannuation system

This Thesis is focused on the superannuation system. It is important to bear in mind however that superannuation is only one 'Pillar' of the government's retirement incomes policy. There are other means by which individuals can save to fund consumption in retirement, and there are other sources of income in retirement.

In particular, the Age Pension plays an important and often underestimated role, as does taxation relief on capital gains on the family home[48] and a variety of other welfare benefits. Indeed there may even be a feedback loop at play. In theory at least, individuals will optimise their position across all the alternative sources of retirement income. Indeed, as Thorpe et al note,[49] the presence of the government's Age Pension as a safety net means that individuals might take the

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47 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate responsibility: managing risk and creating value* (2006).

48 See for instance Cliff Bingham, 'Impact of Private Saving and Longer Careers on Retirement Incomes' (Paper presented at 11th Annual Colloquium of Superannuation Researchers, Centre for Pensions and Superannuation, UNSW, Sydney, July 2003).

49 Susan Thorp, Geoffrey Kingston and Hazel Bateman, 'Financial engineering for Australian Annuitants' in Hazel Bateman (ed), *Retirement provision in scary markets* (Edward Elgar, 2007), 123.

opportunity to be risk-taking within superannuation, which might in turn inspire an element of ‘moral hazard’.[50]

The superannuation system does not, therefore, bear by itself the burden of providing for the future retirement incomes of working Australians. The Age Pension operates as a safety net, and other avenues for saving are available. The superannuation system is not the ‘be all and end all’, and the regulatory system that shapes and protects it need not eliminate all risks so long as it, in conjunction with the other Pillars, promotes the achievement of a dignified retirement for all Australians.

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50 World Bank, *Averting the Old Age Crisis* (OUP, 1994), 36.

1.2 Types of superannuation benefit

Part 1.1 established that the superannuation exists to provide a means by which individuals will save during their working (earning) lives to accumulate assets that can fund some, or all, of their expenditure in retirement. Precisely how that accumulation of entitlement occurs can vary however.

There are essentially two types of superannuation benefit to which members of a superannuation fund may be entitled: defined benefit ('DB') and defined contribution ('DC'). The importance of this phenomenon to this Thesis is the fact that both types are delivered by institutions constituted as trusts. That the modality of a trust can be employed to administer both DB and SC schemes is testimony to the flexibility of the trust form to adapt to different circumstances, a point that will be discussed in more detail in Chapter 4.

Defined contribution schemes

Members of a defined contribution ('DC') scheme make contributions to a superannuation fund directly or, more often, indirectly through the payroll of their employer. Members receive the accumulated value of those contributions at the time of their retirement. For this reason, in Australia they are also sometimes termed 'accumulation funds.'

The member in a DC scheme bears the investment risk: if the investment assets in the superannuation fund fall in value, so too does the value of the member's account. Together with the increasing reliance on the superannuation system as a means of providing retirement incomes, this means that individuals bear more of the financial risks associated with funding retirement expenditure than was the case in previous decades. This relocation of risk affects the substantive settings in the system in ways that are discussed in Chapter 8.

In addition, many DC schemes today offer investment choices to members (termed 'member investment choice'). This enables the member to choose the investment strategy that applies to his or her contributions. However the provision of such choices by a trustee dramatically complicates (and may even render ambiguous) the location of accountability for poor investment performance. Does responsibility for the investment performance of the fund still reside with the trustee, or can the trustee disclaim all responsibility? As Part 5.3 describes in detail, the reality is altogether more complex, conditional and nuanced than either of those extremes.

Defined benefit schemes

Defined benefit schemes are designed to provide members with a benefit on retirement calculated according to a pre-determined formula, typically based on salary and tenure. The employer is usually required to make sufficient contributions to fund the payment of those benefits.[51] Because the date when the benefit will be payable for younger members is many decades away, the size of the contribution required each year is calculated actuarially,[52] subject to technical rules related to solvency and the requirements of the Superannuation Guarantee.[53] Crucially in the context of this Thesis, this fundamentally affects the duties owed by the trustee. The trustee responsible for a DB scheme is not simply a passive guardian of the assets in the trust.[54] The trustee must do what it can to ensure that the trust can meet its financial obligations when they fall due, which includes communicating, and

51 However, as we shall see in Chapter 4, the terms of the trust deed can affect this allocation of responsibility quite materially: *Lock v Westpac* (1991) 25 NSWLR 593. For a recent example, see Sally Patten, 'Super fund shortfall riles union', *Australian Financial Review*, 19 December 2011, 4.

52 A member's entitlement prior to retirement age will typically be determined by a vesting schedule set out in the scheme's governing rules.

53 *Ansett Australia Ground Staff Superannuation Plan v Ansett Australia Ltd* [2002] VSC 576, [30]-[44].

54 David Pollard, 'Trustees' duties to employers: the scope of the duty of pension trustees' (2006) 20 *Trust Law International* 21, which also contains the view that the trustee may also be under a legal obligation (in the UK at least) to consider the perspective of the employer. Arguably this view has been overtaken in Australia by ss 62 and 117 of the *Superannuation Industry (Supervision) Act 1993* (Cth) ('*SIS Act*') (see further below). See also Edward Nugee, 'The duties of pension scheme trustees to the employer' (1998) 14 *Trust Law International* 216.

potentially negotiating, with the fund sponsors about the level of contributions required to keep the fund solvent.[55]

Defined benefit schemes were the predominant form of superannuation scheme in the period between 1950 and 1990, but their relative importance has waned more recently. The assets in DB schemes now account for less than 18% of all non-SMSF assets,[56] down from just 24% in June 2005,[57] and a much larger percentage in the years before that.[58] This is because most DB schemes in Australia are now closed to new members. More specifically, the trend can be attributed to a combination of legislative change (including the *SIS Act* and most particularly the introduction of the Superannuation Guarantee in 1993), changes to accounting principles (including most recently AASB 119) [59] and recognition by employers and the public sector of the true costs of meeting DB promises.[60] Notwithstanding this, the long-lived nature of superannuation means that the DB schemes will continue to be important for the system for many decades to come.

55 The practical reality that trustees may need to negotiate with the sponsoring employer is vividly illustrated in the cases concerning pensions surpluses, including *Lock v Westpac*, above n 51; *ASEA Brown Boveri Superannuation Fund v ASEA Brown Boveri* [1999] 1 VR 144; *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862.

56 APRA, *Annual Statistical Bulletin* (2011).

57 Ibid.

58 Precise data are not available for the period before 2005, but the data that are available support this statement. See for instance Bateman and Piggott, above n 12.

59 Australian Accounting Standards (AASB19) now require recognition of any surplus (deficit) on the balance sheet of the sponsoring employer and limited recognition of changes in any surplus (deficit) on its income statement. AASB is broadly consistent with International Accounting Standard IAS19. See Isabel Gordon, 'Accrual Accounting Catches Up with Employers Sponsoring Defined Benefit Plans' (2005) 4(1) *Financial Reporting Regulation and Governance*.

60 See for instance Cooper Review, *Final Report: Part Two*, 176.

Hybrid funds

The trend away from DB schemes is masked in the statistics reported above by the fact that DB schemes are often administered in so-called 'Hybrid' funds which contain both DB and SC schemes.[61] The existence of Hybrid funds is important in the context of this Thesis because it points to the complexity of the schemes that many fund trustees are required to administer. Trustees of Hybrid funds will have to take responsibility both for the tasks expected of a trustee of a DC scheme and the tasks expected in respect of a DB scheme. The challenge will be compounded by the practical reality that the responsibilities owed by the trustee in respect of the DB scheme(s) will not diminish even though the DB scheme(s) may be closed to new members and may be declining in both relative and absolute size.

[61] APRA, *Annual Superannuation Bulletin* (2010), 7.

1.3 Superannuation as a 'system'

This Thesis employs the term 'system' to describe the phenomenon of collective activity known as superannuation. It does so deliberately to avoid shortcomings associated with terms such as 'market' or 'industry'. [62]

The term 'industry' is inadequate in the context of this Thesis because the analysis presented here extends beyond an analysis of the private sector actors offering their products and services to individual consumers. It encompasses both those types of actors but it also encompasses the processes and interactions between them, and indeed the rules that guide the interactions between the participants.

Similarly, to characterise the phenomenon as simply a "market" is to misconceive the nature of some, at least, of the motive forces that animate it. In particular, it underemphasises the importance of the public policy objectives underpinning the system that were identified and discussed in Part 1.1. That is not to say that the competitive pressures that animate a 'market' do not play a role. They do. However there are other influences on the behaviour of the actors, and on the structure of the system as a whole, that are vitally important and must therefore also be considered. This Thesis therefore requires a more sophisticated characterisation. Characterising the phenomenon as a 'system' goes some way towards achieving this.

Why a 'system'? Meadows describes a system as 'an interconnected set of elements that is coherently organised in a way that achieves something'.[63] This description highlights that a system is constituted both by the elements present in the system as well as the interconnections between those elements. Moreover it is possible to distinguish between those interconnections that have the character of 'transactions'

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62 There are also resonances with the conception of a system present in the work of Luhmann and Teubner: Niklas Luhmann, *Law as a Social System* (OUP, 1995); Gunther Teubner, 'Substantive and Reflexive Elements in Modern Law' (1983) 17 *Law and Society Review* 239.

63 Donella Meadows, *Thinking in Systems*, (Chelsea Green, 2008), 11.

between the elements[64] and those of a higher level of abstraction that govern the nature of those transactions, which might be termed ‘meta-connections’. The rules comprising the regulatory scheme governing the superannuation system, including those provided by trust law, are a prime example of such ‘meta-connections’. As such, ‘system’ is a more accurate and fertile characterisation of the phenomenon under examination in this Thesis than either ‘industry’ or ‘market’.

The superannuation ‘system’ as it is conceived in this Thesis is thus not just the set of participants (members, trustees, fund managers, regulators and so on) present in the system. The system also includes the transactions between those participants and, most importantly for this Thesis, the regulatory scheme that defines and conditions those transactions. Parts 1.4 and 1.5 introduce the most important private market participants in the system. Chapter 2 introduces the regulatory scheme and the most important public regulatory agencies.

Before moving to those descriptions it is convenient to highlight several important insights afforded by the systems perspective. Each is implicit in the descriptions that follow but they deserve separate recognition here.

The first is that the presence of a meta-connection is sometimes under-estimated. For instance, to term someone a ‘trustee’ is to attach a set of meta-connections to that person, or, to introduce language employed later in this Thesis, to locate them in a matrix of accountabilities. The person is a person first (whether that is a natural person or a corporation) and it is only the application of certain rules to govern that person’s transactions with respect to certain items of property and with respect to certain individuals that endows the person with the character of ‘trustee’. The rules, or meta-connections, maketh the trustee, as it were.[65] Moreover they do so not just

64 The term transaction here extends beyond its colloquial meaning to encompass a broader set of interactions, including, for instance, direct and indirect communication between the actors.

65 This is evocative of, and consistent with, the inductive reasoning expressed by Gummow J in *Breen v Williams* in respect of the identification of fiduciaries: *Breen v Williams* (1996) 186 CLR 71, 137-8, and also Paul Finn, *Fiduciary Obligations* (Lawbook, 1977).

where the characterisation of the individual as a trustee is an issue, as it is in certain remedial circumstances. The substantive content of the duties owed by the trustee of an express trust constitute the role. They define and condition it in ways that will be more thoroughly excavated in Chapter 5 and 6 below.

At the same time, it is important to recognise that the participants in the superannuation system may have multiple transactions with each other. For instance, it is not unusual for a director of the company acting as trustee of a superannuation fund to be both a member of the fund (and hence a beneficiary) and an executive of the employer company.[66] In such circumstances it is important to clarify in which capacity the person is acting and to ensure that any conflicts between these roles are resolved appropriately. As Mason J noted in *Hospital Products*,[67] simply because an individual owes fiduciary obligations in respect of one aspect of a relationship does not necessarily mean that the other aspects are impressed with the same fiduciary requirements.[68]

Another complexity that is especially evident when applying a systems frame to the superannuation system is that the actors adapt dynamically to the rules applied to them. The actors may even seek to influence the content and application of the rules themselves. The constitution of the system is thus subject to what Meadows terms 'feedback loops'[69] between its elements and their interconnections. These feedback loops are the essence of the 'reflexivity' in systems described by Teubner,[70] but also correspond to the 'regulatory dialectic' described by Black[71] in the field of

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66 As for instance was the case in *Re HIH Superannuation* [2003] NSWSC 65 and *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32.

67 *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41, 98.

68 See also *Breen v Williams*, above n 65, 82, 108, 137.

69 Meadows, above n 63, 27.

70 Teubner, above n 62.

71 Julia Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) 3(4) *Capital Markets Law Journal* 425, 431. The term 'regulatory dialectic' first appears in Edward Kane, 'Accelerating Inflation, Technological Innovation, and the Decreasing Effectiveness of Banking Regulation' (1981) 36(2) *Journal of Finance* 355.

regulatory theory and the ‘cautelary jurisprudence’ described by Getzler in relation to trust law.[72]

The systems perspective highlights the need to recognise the existence of those feedback loops in understanding how the system came to be in its current shape and, critically, to be aware of their presence when making recommendations about changes to the system. The relationship between the regulatory scheme (of which trust law is part) and the rest of the system is thus dynamic in the sense that the institutional actors adapt in response not just to each other and to exogenous shocks, but also to changes to the regulatory scheme and to changes in the way the regulatory scheme applies to them and their transactions. That dynamic is a recurrent theme in this Thesis.

72 Joshua Getzler, ‘Legislative incursions into modern trusts doctrine in England: The Trustee Act 2002 and the Contracts (Rights of Third Parties) Act 1999’ (2002) 2 *Global Jurist Topics*, 1.

1.4 Types of superannuation fund

The government's encouragement of private market participants to administer the superannuation system has seen the pursuit of a variety of business or operating models by superannuation funds. Funds are often grouped into 'industry sectors' for analytical purposes on the bases of these operating models.

APRA's classification identifies four main types of superannuation arrangement in which responsibility is borne by a trustee distinct from the beneficiaries: industry funds, corporate funds, public sector funds and retail funds.[73] Each is described briefly below.

Industry funds

Industry funds are typically associated with the trade union or unions relevant to a particular industry. Although some date back decades,[74] most are creatures of the past twenty years. Even so, they are amongst the largest superannuation funds today both in terms of number of members and total assets. Historically they have catered to the blue collar workforce in industries such as building,[75] healthcare[76] and hospitality,[77] but several of the larger funds have formed from successive mergers of funds from unrelated industries.[78] They are overwhelmingly defined contribution schemes and, because of their industry scope, typically accept superannuation contributions from a large number of employers.

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73 APRA, *Classification of superannuation entities* (May 2005). Note Self-managed Superannuation Funds (SMSFs) in which members act as trustees of their own fund are outside the scope of this Thesis.

74 For instance MTAA < www.mtaasuper.com.au> and Victorian Independent Schools Super Fund <www.vissf.com.au>.

75 For instance C+BUS <www.cbussuper.com.au>.

76 For instance HESTA <www.hesta.com.au> and HealthSuper <www.healthsuper.com.au>.

77 For instance HOSTPLUS <www.hostplus.com.au> and Intrust Super <www.intrustsuper.com.au>.

78 For instance Australian Super <www.australiansuper.com> and SunSuper <www.sunsuper.com.au>.

Corporate funds

Corporate funds are established at the discretion of an employing company. Historically companies often established them to administer DB schemes but financial and other pressures have seen these all now closed to new members.[79] This means that most members of corporate funds are today contributing to DC schemes. In fact, many of these funds have been closed or merged as a result of the increasing regulatory burden. [80] Other employers have elected to 'outsource' their superannuation obligations and have selected a master fund (see below) for their employees. As a result, less than 150 of these funds are currently operating, down from over 4000 in 1995.[81]

Public sector funds

Public sector funds are established for the provision of retirement benefits for employees in the local, state and commonwealth public sector. Some relatively specialised groups of employees[82] are covered by dedicated funds but most are included in one of the large, omnibus funds operated by the various levels of government.[83] For the most part these funds are established by statute and elect to come under the jurisdiction of the *SIS Act*.[84] Historically many of these funds have administered DB schemes and have been underfunded. Most of these DB schemes

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79 Cooper Review, *Final Report: Part Two*, 176.

80 See also Ross Clare, 'The shape of things to come – the impact of choice and APRA licensing' (Paper presented at 14th Annual Colloquium of Superannuation Researchers, Centre for Pensions and superannuation, 20-21 July 2006).

81 APRA, above n 56.

82 For instance employees from the emergency services (ESSSuper <www.esssuper.com.au>), civil aviation workers (AvSuper< www.avsuper.com.au>) and university staff (Unisuper <www.unisuper.com.au>)

83 For instance the Commonwealth CSS and PSS schemes, Q Super in Queensland and the Local Government Super Scheme in NSW.

84 *SIS Act*, s46 provides that an exempt public sector superannuation scheme is taken to be a complying superannuation scheme for the purposes of the *Superannuation Guarantee (Administration) Act 1992*.

are now closed to new members. New employees are typically enrolled in DC schemes.

Retail funds

Retail funds are superannuation funds run by financial institutions on a commercial ‘for profit’ basis. The appellation ‘retail’ derives from the origin of these products as financial products offered by financial institutions for investment by individual retail investors. This genesis is no longer especially consequential.

One increasingly prominent example of a retail fund is the master trust. These are trusts that comprise a number of sub-funds where the financial institution provides the trustee function but may contract with other parties to manage sub-funds or to offer discrete financial products. Historically master funds were vehicles used by financial planners to offer a suite, or menu, of financial products to clients whose investments were co-mingled with other investors’ under a single umbrella legal structure. This ‘menu’ style of product offering remains an important part of the industry. However, the advent of licensing requirements for trustees (see Chapter 2 below) has seen many employers move their corporate fund into this type of arrangement to take advantage of the administrative and trustee functions offered by the financial institution within the master fund. In this case the arrangement retains much of the ‘wholesale’ flavour common to the corporate, industry and public-sector sectors of the industry, even though it is employing a legal structure formally derived from a ‘retail’ investment product intended for individuals rather than the pooled contributions of many individuals.

Trends

Table 1 presents an historical picture of the number of funds, and the quantum of assets for which they were responsible, across the different industry sectors.

	Jun 1995		Jun 2000		Jun 2005		Jun 2010		Dec 2011	
	# of funds	$bn	# of funds	$bn	# of funds	$bn	# of funds	$bn	# of funds	$bn
Corporate	4,211	55	3,389	67	963	53	171	60	128	54
Industry	152	15	155	49	92	120	65	219	58	247
Public sector	97	59	81	102	43	129	39	173	39	205
Retail	541	62	293	133	226	243	154	346	137	358
Sub total	**5,001**	**191**	**3,918**	**351**	**1,324**	**544**	**429**	**797**	**362**	**864**
Other funds	100,447	28	210,667	72	302,249	172	412,560	382	464,374	386

Source: Source: APRA, Superannuation Trends (Sept 2004); Annual Superannuation Bulletin (2005); Annual Superannuation Bulletin (2010); Quarterly Superannuation Bulletin (Dec 2011). All available at www.apra.gov.au.

The most obvious trend apparent in the table is that the number of funds (other than Self Managed Superannuation Funds) has dramatically declined over the past fifteen years. This has occurred even though the quantum of assets managed by those funds has grown dramatically. This has implications across a number of fronts relevant to this Thesis. For instance, it reduces the inherent diversification across the system by concentrating industry and asset market power in fewer hands. The value of this feature of the industry to the robustness of the system as a whole is described in Chapter 8. At the same time, the reduction in the number of funds reduces the number of individuals required to act as directors of trustee companies, whilst the increase in size (and complexity) arguably raises the standards of skill required of those individuals. The regulation of the competence required of the directors of companies acting as trustees of superannuation funds is discussed in Chapter 5.

One important trend not apparent from the table is that the distinction between the traditional sectors is becoming increasingly blurred.[85] Nearly two-thirds of industry

[85] Cooper Review, *Final Report: Part One*, 7.

funds have become ‘public-offer’[86] funds. This was once the exclusive domain of the ‘retail’ sector. There is a related increase over the same period in the frequency with which funds in the not-for-profit sector are offering investment choices and advisory services to their members, and are seeking to develop brand awareness through advertising, sponsorship and other commercial activities. In this sense, then, the industry is becoming more homogeneous rather than less.

[86] A ‘public offer’ fund is a fund that complies with Part 19 of the *SIS Act* and Chapter 7 of the *Corporations Act* in order to offer membership of the fund to the public. For more detail see Chapter 2.

1.5 'Inside' a modern superannuation fund

This Part identifies the main participants in a typical superannuation fund and describes their roles from a functional perspective. The description below ought not to be taken to be an accurate description of all funds, or indeed any fund in particular. The precise legal relationships and internal processes can and do vary between superannuation funds. However the description presented here will serve as a paradigm on which the descriptions in later Chapters rely.

The superannuation fund as a 'virtual' institution

It is axiomatic that a trust, unlike a corporation, has no separate existence. The trustee of the fund and the members *qua* beneficiaries are in a relationship of trust, but there is no separate juristic person in which the various duties and right repose; the relationship is a direct one between trustee and beneficiary in respect of certain property.[87]

This applies in respect of the trust at the juristic heart of a superannuation fund also. However a modern superannuation fund is a 'virtual' institution[88] in another sense also. The trustee sits at its core both legally and functionally, but in most cases there will be a host of other entities involved in the administration of the trust.[89] The boundaries of the institution that is a modern superannuation fund are therefore hard to draw definitively.

Trust law traditionally had misgivings about the legality of a trustee engaging third parties to perform tasks for the trust that were more than ministerial. These

87 J D Heydon and M J Leeming, *Jacobs Law of Trusts* (LexisNexis Butterworths, 7th ed, 2006), [101].

88 The concept of a virtual corporation as a network of inter-reliant capabilities co-ordinated towards the achievement of some objective can be traced to William Davidow, and Michael S Malone, *The virtual corporation. Structuring and revitalizing the corporation for the 21st century,* (Harper Business, 1992).

89 Kevin Liu and Bruce Arnold, 'Australian Superannuation: The Outsourcing Landscape' (*Working Paper*, APRA, July 2010).

concerns were at one time voiced in respect of superannuation funds also.[90] However the concerns have now largely been resolved in respect of superannuation funds as the *SIS Act* clearly anticipates that superannuation funds will appoint agents to perform certain tasks (see further below). As a result, most superannuation funds now employ functional practices similar to those employed by other institutional investors. This outsourcing enables the trustee to harness the skills and resources of a wide range of experts in highly specialised fields such as investment management, asset custody and member administration.[91]

The outsourcing occurs pursuant to the powers granted to the trustee either expressly or impliedly in the trust instrument. They are effected by contracts between the trustee and the service providers. It is these bilateral and multi-lateral relationships that together with the relationship between the beneficiaries and the trustee create a web of interlocking accountabilities that create the institution, centred on the trust but extending beyond the trustee and beneficiaries, that is a modern superannuation fund.

The Participants in a Superannuation Fund

The key participants in a superannuation fund are the members and trustee. However a modern superannuation fund comprises a wide range of participants beyond those two roles. The nature of membership and of trusteeship of a superannuation fund is outlined below, as are the roles of the other key participants in a typical superannuation fund.

The Members

Superannuation law makes frequent use of the term ‘member’. Notably, however, nowhere in the *SIS Act* is there a definition of ‘member’ – if contentious it will be a

90 See for instance John Lehane, ‘Delegation of Trustees Powers and Current Developments in Investment Funds Management’ (1995) 7 *Bond Law Review* 36.

91 Deloitte, *Report on Default Fund costs under the MySuper proposals*, 20, reproduced in Cooper Review, *Final Report: Part Two*, 51, 75, 164.

matter of construction of the terms of the trust instrument, as in *Re HIH Superannuation*.[92]

One area where confusion can arise is where the terms member and beneficiary are used as synonyms. This happens quite commonly in the superannuation context and is usually benign. It is however incorrect as there are important categories of beneficiary who are not strictly members. Depending on the terms of the trust and on the circumstances of the enquiry, these might include pensioners, deferred members, dependants and spouses of members (as contingent beneficiaries of death benefits, for instance) and former members.[93] These individuals may, depending on the terms of the trust instrument, have rights under the trust that need to be respected.

Members have neither legal nor equitable right to specific assets in the fund corpus.[94] This is true whether the members' benefits are of the DB or the DC form. Their interest is better described as 'an expectancy'.[95] However that expectancy must be seen in the light of the contractual employment relations which surround most superannuation arrangements.[96]

The *SIS Act* provides members with the right to request certain prescribed types of information.[97] This reinforces the right beneficiaries have at Equity to request documents, including actuarial reports, trust deeds and trust accounts. However, as is discussed in Chapter 9, this right is less valuable than it appears, since access to

92 *Re HIH Superannuation*, above n 66.

93 *Re HIH Superannuation*, above n 66; *Invensys v Austrac Investments* (2006) 198 FLR 302, [55], [82].

94 *Re HIH Superannuation*, above n 66.

95 *Re Coram* (1992) 109 ALR 353, 356-7 (O'Loughlin J). See also *Australian Petroleum Nominees v Member of the Superannuation Complaints Tribunal* (1997) 79 FCR 332. Also G Hill, 'The True Nature of a Member's Interest in a Superannuation Fund' (2002) 5(1) *Journal of Australian Taxation* 1.

96 *Finch v Telstra*, above n 26, [33].

97 *SIS Act* s 52(2)(h), as amplified by *SIS Regulations* reg 4.01.

information does not counter the courts' traditional refusal to consider the merits of a trustee's decision.[98]

The Trustee

To say that the trustee is pivotal to the operation of the trust is of course tautological. However it is also an accurate description of the functional reality as the trustee appoints all agents and is the party primarily responsible to members and to regulators.

It should not be surprising therefore that the regulatory scheme places great reliance on the trustee for governance of the affairs of the institution we know as the superannuation fund. It does so in two main ways.

First, as is discussed in more detail in Chapter 4, trust law identifies the trustee as the appropriate location for certain responsibilities with respect to the institution. The trustee can contract with external parties and can delegate certain responsibilities, but it cannot escape primary accountability for the administration of the trust.

Second, the regulatory scheme enforces certain matters relating to the content of the role played by the trustee. So for instance s 29P of the *SIS Act* requires the trustees of a fund to document the risk management plan which the trustee board

> is to apply to identify, monitor and manage the risks that arise in operating [the superannuation fund].

This is in addition to the trustee's obligation to formulate an investment strategy for the fund.[99] The trustee is also responsible for contracting with actuaries, auditors and other service providers to the trust[100] and for paying the tax owed by the

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98 *Crowe v SERF* [2003] VSC 316. For a discussion that suggests that members of a superannuation fund deserve a more extensive right to documents affecting their benefits, see Lisa Butler, 'Reviewing Trustees' Discretions: The Right to Reasons' (1999) 7 *Australian Property Law Journal* 1. Also David Hayton, 'Pension Trusts and Traditional Trusts: Dramatically different species of trust' (2005) *Conv.* 229.

99 *SIS Act*, s52(2) provides that this duty shall be implied into the trust instrument if not actually contained therein.

100 See further below.

superannuation fund out of trust assets.[101] Part 4 of the *SIS Act* requires the trustee to provide annual return to the Regulator and Part 12 of the *SIS Act* outlines a set of administrative responsibilities required of the trustee of a superannuation fund.

Taken together, these provisions ensure that the trustee is vitally involved in the day to day operation of the trust both in practice and in theory. As Chapter 4 notes, this very practical engagement in the day to day operations is intended to facilitate the regulation of the system by ensuring that the subject of the regulatory activity (the trustee) is actually in a position to promote compliance with the regulatory rules.

The Legal Personality of the Trustee and its directors

The trusteeship of a superannuation fund can take several forms. The *SIS Act* anticipates individual trustees, groups of individual trustees and bodies corporate.[102]

For reasons that are outlined in Chapter 4, most trustees of superannuation funds are incorporated entities. One consequence of this is that the individuals serving on what is often colloquially termed the superannuation fund board are in fact directors of the trustee company. As such they perform tasks analogous to, but perhaps not identical to, individuals acting as joint trustees of the fund.[103] Many of these individuals are compensated for their services,[104] and some are appointed in order for the fund to take advantage of their special expertise. Many, however, are neither elected by members nor selected by the board.[105] Instead they are nominated by either the employer, a representative body (such as a trade union or employer body) or, in the case of 'retail' funds, by the financial institution responsible for promoting and administering the fund.

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101 *Income Tax Assessment Act 1993* (Cth), s 278.

102 *SIS Act*, s 10(1).

103 Scott Donald, 'No Soul to Damn, no Body to Kick': Cooper and the Corporate Trustee' (Paper presented at LCA Annual Superannuation Conference, *Super; a paradise lost?*, Gold Coast, 2011).

104 APRA, 'Superannuation fund governance: Trustee policies and practices' (2008) *Insight*.

105 Ibid, 16.

A demographic description of the director cohort

There are around 1700 individuals serving on the boards of APRA licensed superannuation fund trustee companies today.[106] They are predominantly male[107] and aged between 45 and 60.[108] The overwhelming majority have tertiary qualifications.[109] In many ways this resembles the demographic profile across senior corporate positions generally, albeit that the equal representation requirements of the *SIS Act*[110] in part reflect the social inclusion objective identified above.[111] The tension between these requirements and trustee competence is discussed in Chapter 5.

Agents of the Trustee

The Administrator

The task of maintaining records of member accounts is typically delegated by the trustee to a third party, called an administrator. The role of administrator is not expressly recognised in the *SIS Act*, but is recognised by APRA[112] and would fall under the rule in *Speight v Gaunt*[113] in that it is necessary for the smooth, efficient and prudent management of the affairs of the trust.

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106 APRA, *Annual Superannuation Bulletin* (2010), 15.

107 Ibid, 15.

108 APRA, above n 104, 6.

109 Ibid , 4.

110 In general terms, Part 9 of the *SIS Act* requires that the trustee boards of employer-sponsored superannuation funds be comprised of equal numbers of employer and member appointed representatives.

111 Directors drawn from the 'rank and file' account for 47% of the directors of boards of corporate funds, 27% of industry funds, 26% of public sector funds and just 7% of retail funds; APRA, above n 104, at 14.

112 See for instance APRA, *Superannuation Guidance Note, Outsourcing;* SGN 130.1 (July 2004) in which APRA expresses its view that the provision of fund administration services falls within the definition of 'service provider' for the purpose of *SIS Regulations* reg 4.16(1).

113 (1883) 9 App Cas 1.

The investment managers

Trustees in many cases delegate the task of managing the assets of the trust to one or more investment managers. The *SIS Act* requires that the appointment(s) be in writing, [114] and provides that such an appointment does not absolve the trustee from overall responsibility for setting the investment strategy.[115] An investment manager so retained must be a corporate entity.[116]

The Custodian [117]

Ordinarily the courts are loath to allow individuals (corporate or otherwise) other than the trustee to hold the indicia of legal title to a trust's assets. [118] However modern investment trusts and companies commonly use custodians to hold the indicia of title of securities in their portfolio.[119] Custodians are also typically responsible for processing transactions in those securities, including consequential transactions such as foreign exchange transactions and margin calls. The practice is implicitly endorsed by Part 15 of the *SIS Act* which sets out the rules for eligibility for persons to be the custodian of a regulated superannuation entity.

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[114] *SIS Act*, s 124.

[115] *SIS Act*, s 52(2)(f).

[116] *SIS Act*, s 125.

[117] Defined in s 10(1) of the *SIS Act* as 'a person (other than a trustee of the entity) who, under a contract with a trustee or an investment manager of the entity, performs custodial functions in relation to any of the assets of the entity'.

[118] See, for instance, *Field v Field* [1894] 1 Ch 425.

[119] See, for instance, David Hayton, 'Developing the Law of Trusts for the Twenty First Century' (1990) 106 *Law Quarterly Review* 107. In practice the trustee will typically appoint a Master Custodian, which will in turn appoint a network of sub-custodians to effect transactions and secure title in different markets.

Other private market participants

The Actuary[120]

Actuaries play a role in funds that are responsible for the administration of DB schemes. The most important role of the actuary is to provide an assessment of the quantum of contributions required from the sponsoring employer(s) to achieve an agreed level of funding for the fund. In almost all cases this is a service provided to the sponsoring employer(s), rather than the trustee of the fund. The cost of retaining the actuary is therefore met by the employer.

Actuaries are also required to notify a trustee and the Regulator if they believe the financial position of the fund is, or may be about to become, unsatisfactory (ie insolvent)[121] or if they believe a breach of the *SIS Act* or the *Financial Sector (Collection of Data) Act 2001*[122] has occurred or may be about to occur. Moreover, a person becoming aware of a failure to implement an actuary's recommendation is required to disclose that failure to the trustee, and, if the interests of members or beneficiaries are affected, the regulator.[123]

The Employer

The employer's obligations in the superannuation context arise mostly from the contractual employment relations they have with employees rather than trust law.[124] Hence the tenor of conduct expected of the employer in relation to the trust and its beneficiaries is better described as one of 'good faith', than fiduciary.[125] That

120 Defined in s 10(1) of the *SIS Act* as a person who is a Fellow or an Accredited Member of the Institute of Actuaries of Australia.

121 *SIS Act*, s 130(1).

122 *SIS Act*, s 129(1).

123 *SIS Act*, s 130C.

124 Key amongst these is the obligation to make the agreed contributions in a timely manner, which is reinforced by s 64 of the *SIS Act*.

125 See for instance Browne-Wilkinson VC in *Imperial Group Pension Trust v Imperial Tobacco* [1991] 2 All ER 597, 606, and, in Australia, *Lock v Westpac*, above n 51; *AMWU v Shell* (1993) 27 ATR 195.

said, as Brereton J recently noted in *Re Kca Super Pty Ltd*,[126] even a requirement on the employer to act in good faith would not necessarily preclude it from exercising a power reserved to it to dissolve the fund, an act which would seem to be to the inevitable detriment of employees.

The employer clearly has no interest in the assets of a DC scheme. However the employer's interest in the assets of the trust where the scheme is a DB scheme is less clear. Dal Pont asserts that where the trust instrument contemplates the employer receiving a distribution of any surplus, then the employer is in fact a beneficiary.[127] Pollard also seeks to identify an employer interest in the fund.[128] He argues that the employer should be regarded as a 'quasi-beneficiary' by virtue of the effect that the trustee's decisions (for instance with respect to investment strategy, crediting rate or benefit augmentation) will have on its financial obligations to the trust. With respect, care should be taken with both views. In respect of Dal Pont's unsupported contention the employer has at best a contingent interest and so the terminology of 'beneficiary' has the potential to mislead because the trustee will not owe duties to the employer until that contingency is satisfied. On the other hand, Pollard's view ignores the fact that there are other parties whose financial position can be materially adversely affected by the decisions of a trustee (any of its professional agents, for instance) and it is not suggested that they should be included as a quasi-beneficiary. It is also hard to see what the pre-fix 'quasi' adds in this context; trust law is perfectly capable of ranking competing beneficiary claims without creating a new characterisation with unclear implications.

Finally it is worth reiterating a point made earlier. The universality of the Superannuation Guarantee, and the trend towards DC schemes to which it contributed, has substantially reduced the importance of the employer in the

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126 *Kca Super Pty Ltd as Trustee of the Superannuation Fund Known as "Kca Super" (No 2)* [2011] NSWSC 1301.

127 Gino Dal Pont, *Equity and Trusts in Australia* (Lawbook Co, 5th ed, 2011), [28.165], n 196.

128 David Pollard, 'Trustees' duties to employers: the scope of the duty of pension trustees' (2006) 20 *Trust Law International* 21.

superannuation system. Their role, once the required contributions have been made to a complying superannuation fund, is limited indeed.[129]

Concluding Comments

Australia's superannuation system is both complex and dynamic. Implicitly then, trust law, as part of the regulatory scheme governing those interactions, must accommodate a diversity of type (Occupational vs Additional, DB vs DC) and purpose (commercial/not-for-profit) as well as an increasingly differentiated set of agency and advisory arrangements that sees many highly specialised functions 'outsourced' to external parties. It must also accommodate evolving processes and institutional forms. The ability of trust law to contribute to the regulatory scheme given this complexity, dynamism and diversity, is assessed in Chapters 3 to 8.

129 The shortcomings of the regulatory scheme in this respect are discussed briefly in Scott Donald, 'What's in a Name? Examining the Consequences of Inter-legality in Australia's Superannuation System' (2011) 33 *Sydney Law Review* 295, 307-8.

Chapter 2

The regulatory scheme shaping superannuation

'The Government is introducing [the Superannuation Industry (Supervision) Bill 1993] in order to give added protection to superannuation savings and to promote a more efficient superannuation industry, while avoiding the imposition of unreasonable supervisory and compliance costs.'

Gary Johns, MP
Parliamentary Secretary to the Treasurer[1]

The regulatory scheme shaping superannuation is a complex tapestry comprising a number of sources of law. This Chapter focuses on the two most important of these: trust law and statute. It establishes that orthodox trust law principles continue to play an important part in the constitution and operation of the key institution in the superannuation system, the superannuation fund. It also identifies and briefly describes the most important statutes present in the regulatory scheme, and the regulatory objectives that underpin them: member protection and efficiency. This Chapter thus provides a context in which the contribution made by trust law to the regulatory scheme can be assessed generally (Chapter 3) and in detail (Chapters 4 to 8).

The Chapter proceeds as follows:

Part 2.1 provides an overview of the regulatory scheme and introduces in more detail the notion of 'inter-legality,' one of the key themes in this Thesis.

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1 Commonwealth, *Parliamentary Debates,* House of Representatives, 27 May 1993 (Gary Johns), 1101.

Part 2.2 defines what references to 'trust law' connote in the context of this Thesis and counters the suggestion that superannuation funds ought to be considered *ejusdem generis*.

Part 2.3 provides an overview of the key statutory elements of the regulatory scheme; in particular the *Superannuation Industry (Supervision) Act* ('*SIS Act*').

Part 2.4 then identifies the objectives underpinning the regulatory scheme shaping the superannuation system: efficiency and member protection.

Part 2.5 concludes with a brief description of the private and public modes of enforcement present in the regulatory scheme.

2.1 Introduction to the regulatory scheme

Chapter 1 identified that the superannuation system relies on statutory rules, such as those establishing the Superannuation Guarantee, for its existence. The system also relies on a set of statutory and general law rules ('meta-connections' in the language of Part 1.3) to define the roles of, and relationships between, its constituent parts. These meta-connections together comprise the 'regulatory scheme'.

The regulatory scheme applied to participants in the superannuation system is therefore not simply the collection of statutory instruments applied to the superannuation system. It is a tapestry comprising multiple strands.[2] Some of the strands are imposed from the public domain, most notably the Commonwealth statutes introduced below. Other strands, though, derive from the private domain. These include trust law, the main subject of analysis in this Thesis, and contract.

Importantly, the relationship between the various strands is 'inter-legal' in the sense employed by De Sousa-Santos.[3] That is to say, the various strands in the regulatory tapestry do not simply co-exist; they interlace and rely on each other in complex ways. Chapter 5, for instance, examines examples where trust law informs the interpretation of certain statutory rules and is in turn buttressed by the presence of those statutory rules. Similarly, Chapter 6 describes and analyses the way in which trust law acts as a default source of rules where the other sources are silent or inadequate. Indeed Chapters 3 to 7 of this Thesis can be seen as an articulation and investigation of that inter-legality.

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2 Lord Hoffmann, 'The Direction of Equity and its Role for Superannuation/Pensions in the 90s' Superannuation 94 – A National Conference for Lawyers on Superannuation.

3 Boaventura de Sousa Santos, *Toward a New Legal Common Sense: Law, Globalization, and Emancipation* (CUP, 2nd ed, 2002), 97.

Trust law, inter-legality and the regulatory tapestry

The notion that the regulatory system shaping superannuation is constituted from a number of juridical sources should hardly be a surprise. It is expressly recognised in s 350 of the *SIS Act*, which provides

> It is the intention of the Parliament that this Act is not to apply to the exclusion of a law of a State or Territory to the extent that that law is capable of operating concurrently with this Act.

Importantly, though, the relationship between rules drawn from these different sources is more complex than simply one of co-existence.

The nature of the relationship between the rules drawn from different juridical sources has attracted little attention from the academic community.[4] As result there is little sustained rigorous analysis in the public domain.[5] Text writers typically mention but then quickly pass over the co-existence of the different sources of rules.[6] Commentators, too, seem to take the co-existence for granted.[7] To the

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4 One possible exception is Hanrahan, whose contributions in respect of the funds management industry have tangential application in the superannuation context; Pamela Hanrahan, 'The Responsible Entity as Trustee', in Ian Ramsay (ed), *Key Developments in Corporate Law and Trusts Law* (LexisNexis Butterworths, 2002), 227; Pamela Hanrahan, *Funds Management in Australia. Officers' Duties and Liabilities*, (LexisNexis Butterworths, 2007); and Pamela Hanrahan, 'Directors' liability in superannuation trustee companies' (2008) 2 *Journal of Equity* 204.

5 A small number of Masters and Doctoral theses have addressed questions related to the regulation of the superannuation system, but none has been published. Most notable amongst these is Lisa Butler, *The Priority of the Trust in the Age of Superannuation* (unpublished PhD Thesis, University of Tasmania, 2004).

6 See for instance JD Heydon and MJ Leeming*, Jacobs Law of Trusts* (LexisNexis Butterworths, 7th ed, 2006), [2901]; Gino Dal Pont, *Equity and Trusts in Australia*, (Lawbook Company, 5th ed, 2011) [28.10]; Michael Evans, *Equity and Trusts*(LexisNexis Butterworths, 3rd ed, 2012), [23.15]; Harold Ford, Michael Bryan and P McDermott, *Principles of the Law of Trusts* (Thomson online service), [1.10710]; Peter W Young, Clyde Croft and Megan L Smith, *On Equity*, (LawBook Company, 2009), [6.1230].

7 See for instance Paul Klumpes, 'Collective Investments', Research Paper (Companies and Securities Advisory Committee, Australian Law Reform Commission, 1993); Paul

extent that some commentators do consider in detail the respective roles of trust law[8] and statute, or trust law and contract, for instance, it is limited to a narrow analysis of a particular provision and its trust law analogue or to a particular 'transaction' within the system rather than a broader, more conceptual analysis.[9] This stands in stark contrast to the literature in relation both to corporate and financial services regulation, in which there is a much more developed conversation around the interplay between different sources of rules and the nature of the regulatory scheme generally.[10]

Likewise the courts in considering superannuation-related cases have seldom commented on the nature of this co-existence beyond what is required to address the matter in front of them. A number of cases in which analysis of the relationship between a specific statutory provision and its trust law analogue has been analysed are discussed in detail in Chapter 5. However the courts' deliberations even in those

Ali, Geoff Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries*, (LawBook Company, 2003); Hazel Bateman, 'Regulation of Australian Superannuation' (2003) 36 *Australian Economic Review* 118.

8 The ambit of what is considered trust law for the purpose of this Thesis is described in Part 2.2 below.

9 See for instance Anthea Nolan, 'The Role of the Employment Contract in Superannuation: an Analysis Focussing on Surplus Repatriation Powers Conferred on Employers' (1996) 24 *Australian Business Law Review* 341; Lisa Butler, 'Reviewing Trustees' Discretions: The Right to Reasons' (1999) 7 *Australian Property Law Journal* 1; Paul Ali, 'Adding Yield to Stable Portfolios: Regulating Investments in Australian Hedge Funds' (2001) 19 *Company and Securities Law Journal* 414; Michael Vrisakis, 'Co-habitation of contract and trust relationships in contemporary investment trusts' (2008) 2 *Journal of Equity* 274. Further examples can be found throughout this Thesis, and most especially Chapter 5.

10 In relation to corporate regulation see for instance Ian Ramsay, 'Corporate Law in the Age of Statutes' (1992) 14 *Sydney Law Review* 474; Stephen Bottomley, 'Where did the law go? The delegation of Australian Corporate Regulation' (2003) 15 *Australian Journal of Corporate Law* 105. In relation to financial services regulation, see for instance Julia Black, 'Which Arrow? Rule Type and Regulatory Policy' (1995) *Public Law* 94; Dimity Kingsford-Smith, 'Beyond the Rule of Law? Decentered Regulation in Online Investing' (2004) 26 *Law and Policy* 439; Iain Ramsay, 'Consumer Law, Regulatory Capitalism and the 'New Learning' in Regulation' (2006) 28 *Sydney Law Review* 9.

cases seldom extend to an analysis of the overall relationship between those sources.[11] Attention is typically focussed only on the relevant statutory provision or the construction of the specific terms in the trust instrument.[12]

Two notable exceptions

Lord Justice Hoffmann is one of the few to consider the matter from a broader perspective. Speaking extra-curially in 1994, his Lordship described the interplay of four juridical sources present in Australia's superannuation system:

- contract;
- equitable principles;
- statutory regulation; and
- administrative discretion.[13]

For Lord Hoffmann, the importance of this distillation was that it identified the enhanced role played by statute in defining the role played by each of the strands in the regulatory scheme. His Lordship's analysis also highlighted the potential emergence of inconsistencies within the regulatory scheme resulting from differences in the remedial architecture, as well as the preoccupations and the priorities inherent in the four strands.

Moffatt is another exception. Writing in the UK context, he applied a taxonomy borrowed from the Critical Legal Studies movement to distinguish three realms of social life: *family and friendship*, within which he placed trust law; *work and exchange*, within which he placed employment law; and *state and citizenship*.[14] The

11 One exception is the Administrative Appeals Tribunal decision *Re VBN* [2006] AATA 710. The tribunal's reasoning and the various critiques of that reasoning are presented in detail in Chapter 5.

12 See for instance *Ansett Australia Ground Staff Superannuation Plan v Ansett Australia* [2002] VSC 576, [239] where Warren J describes the relationship as 'symbiotic'.

13 Hoffmann, above n 2.

14 Graham Moffatt, 'Pension Funds: A Fragmentation of Trust Law' (1993) 56 *Modern Law Review* 471.

location of pension plans (superannuation funds) in both trust and employment law meant that they straddled the boundary between two different realms. (Had he been writing in Australia, he might easily have recognised the impact of compulsory superannuation in bringing superannuation law into the third realm, state and citizenship, also.) The doctrinal friction Moffatt identified in the UK pension cases arose from the conflict between the fact that the preoccupations and priorities underlying the three realms are largely independent and, for the most part, unreconciled. More importantly, though, from the perspective of this Thesis, he highlighted the presence of competing preoccupations and priorities across the regulatory scheme arising from the interactions between different juridical sources, a theme already encountered in Chapter 2 and developed in more detail in Chapter 8.

The regulatory scheme as an 'inter-legal' tapestry of rules

This Thesis goes one step further than Lord Hoffmann and into more detail than Moffatt. In assessing trust law's contribution to the regulatory scheme, the analysis here investigates in detail the various ways in which trust law interacts with other strands of the regulatory tapestry. As de Sousa Santos argues:

> More important than the identification of the different legal orders is the tracing of the complex and changing relations among them.[15]

This Thesis, then demonstrates that the various strands in the tapestry of rules constituting the regulatory scheme do not merely co-exist. There is a complex and sometimes subtle inter-relationship between the strands, an inter-relationship that might, following de Sousa Santos, properly be described as 'inter-legality.'[16] The detailed analysis in Chapters 4 – 8, in effect, maps the nature of that inter-legality.

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[15] Boaventura de Sousa Santos, 'Law: A Map of Misreading. Toward a Postmodern Conception of Law' (1987) 14 *Journal of Law and Society* 279, 288.

[16] de Sousa Santos coined the phrase 'inter-legality' to describe the phenomenological dimension of legal plurality in which everyday life crosses or is interpenetrated by different and contrasting legal orders and cultures; de Sousa Santos, above n 3, 97. Closer to home, Kingsford Smith uses the term specifically in relation to the way 'various types of state and decentred regulation interrelate and shape each other',

In the chapters that follow, this Thesis identifies a number of examples where different strands buttress each other; securing jurisprudential space to permit an otherwise vulnerable rule to apply. So for example, s 56(2) of the *SIS Act* renders void any provision in a trust instrument that would have the effect of exempting a trustee from liability for dishonest or intentionally or recklessly careless breaches of trust.[17] This ensures that ordinary trust principles designed to ensure that trustees act honestly and carefully cannot be rendered nugatory by the terms of the trust instrument. Similarly s 52(2) of the *SIS Act* imposes on all trustees of superannuation funds covenants to act honestly, with due care and diligence, and in the best interests of members by implying those covenants statutorily into the governing rules of each superannuation fund. Again this ensures that these key principles of trust law cannot be eclipsed or qualified by the terms of the trust instrument.[18]

Later Chapters identify examples where the different strands reflexively inform each other; providing characterisations of phenomena and roles that facilitate analysis and also criteria that guide curial adjudication. So, for instance, the *SIS Act* employs the term 'trustee' to refer to one of the key actors within the institution it seeks to regulate, the superannuation fund. That designation implicitly conditions the interpretation of the provisions of the *SIS Act* that employ the term in a way that use of a term without such provenance, such as 'responsible entity' arguably would not.

Trust law, then, does not simply supplement the other juridical sources present in the regulatory scheme. The strands operate together in a reflexive, integrated way and the regulatory system gains cohesion from their symbiosis. This is not to suggest, of course, that there are not inconsistencies and dissonances present in the regulatory scheme as a result of this co-incidence of juristic sources. There are, and they are especially evident where the policy objectives underlying the statutory elements have evolved, on which more will be said below. However, as we shall see

Dimity Kingsford Smith 'What is Regulation? A Reply to Julia Black' (2002) 2007 *Australian Journal of Legal Philosophy* 37

17 See Part 4.2 below for analysis and discussion.

18 See Part 4.2 and Chapter 5 for analysis and discussion.

further in Chapters 3 and 4, Parliament clearly intended specifically to enrol trust law in the regulatory scheme. The choice of trust law as the legal infrastructure for superannuation funds was consequential and it was deliberate. It enabled Parliament to harness both the substantivity of trust law and its instrumental capacity in the service of the regulatory scheme.

2.2 The application of trust law to superannuation funds

The discussion thus far has proceeded on the assumption that it is clear what is meant by 'trust law' and that its application to the institutions known as superannuation funds is uncontroversial. This Part addresses those issues directly.

Defining 'trust law'

Trusts are famously 'an institute of great elasticity and generality'.[19] They vary considerably in scale and in complexity and they appear in a wide and diverse range of contexts. Defining the juristic nature of the trust in a way that encompasses that variety while remaining typologically discriminating would be challenging. Indeed, as the learned authors of an early edition of *Jacobs Law of Trusts* concluded:

> It is considerably easier to criticise the many attempts of others at definition than it is to venture a fresh definition which will meet the criticisms made[20]

Articulating a definition of 'trust law'[21] that is satisfactory in all circumstances would therefore be similarly challenging.

Thankfully, such a task is not required in the context of this Thesis. Because superannuation funds are typically constituted as express trusts[22] and the trustees of

19 Maitland, *Equity* (2nd ed, 1936), 23.

20 R P Meagher and WMC Gummow, *Jacobs Law of Trusts* (Butterworths, 6th ed, 1997), 3.

21 Purists may prefer the term 'trusts law' to 'trust law'. The term trust law is used in this Thesis because that is the term employed in lay and public policy discourse in this area.

22 Heydon and Leeming, above n 6, [2907]; Law Reform Commission, *Superannuation*, (1992), 2.18, 5.2, 9.2, 9.16. For all the wrangling over the precise nature of the pension (superannuation) trust, few if any commentators deny this basic conclusion. See for instance David Hayton, 'Pension Trusts and Traditional Trusts, Drastically Different Species of Trusts' [2005] *Conveyancer and Property Lawyer* 229; Scott Charaneka, 'Legal Darwinism: the Evolution of a New Trust Species' (2000) 11 *Insurance Law Journal* 1; Marina Milner, 'Pension Trusts: a New Trust Form' [1997] *Conveyancer and Property Lawyer* 89; Eileen Gillesse, 'Pension Plans and the Law of

superannuation funds are 'status-based' fiduciaries,[23] the doctrinal wrangling over the proper ambit of terms such as 'trust' and 'fiduciary', though important in other contexts, is largely irrelevant here.

The precise scope of what the term 'trust law' connotes in this Thesis is however important to clarify. 'Trust law' in the context of this Thesis refers to the set of principles and rules of general application that govern the relationship between a trustee of an express trust and the beneficiaries of that trust. More specifically, the principles and rules are those which entitle the parties to approach a court of equity to seek such remedies as will secure the entitlements that the trust purports to confer upon them. That is, the rules that together comprise trust law are activated by, and conditioned on, the preparedness of a court of equity to consider intervention.[24]

Another way to express this is that 'trust law' is used in this Thesis to connote a sub-set of rules and principles drawn from equitable doctrine that together constitute an institution recognisable as a trust. Trust law, in this connotation, encompasses those rules relating to the conduct of the trustee *qua* trustee, including the 'fiduciary' obligations of the trustee not to profit from the trust[25] and to be free from conflicting interests or duties,[26] as well as the equitable duties, such as the duty to act honestly,[27] impartially[28] and with due care, skill and diligence.[29] It also

Trusts' (1996) 75 *Canadian Bar Review* 221; Graham Moffatt, 'Pension Funds: A Fragmentation of Trust Law' (1993) 56 *Modern Law Review* 471.

23 A non-exhaustive list of such relationships was identified by Mason J in *Hospital Products v United States Surgical Corporation* (1984) 156 CLR 41, 96. On the notion of status-based fiduciaries generally, see Robert Flannigan, 'The Fiduciary Obligation' (1989) 9 *Oxford Journal of Legal Studies* 285, 291.

24 The crucial role played by the court was well expressed by Roxburgh J in *Re Astor's Settlement Trusts* [1952] 1 Ch 540, 541-2, when his Honour noted

> The typical case of a trust is one in which the legal owner of property is constrained by a court of equity so to deal with it as to give effect to the equitable rights of another.

25 *Tito v Waddell (No2)* [1977] 3 All ER 129.

26 *Keech v Sandford* (1726) Sel Cas T Ch 61; 25 ER 223.

27 *Re Chapman* [1896] 2 Ch 763.

encompasses the remedial consequences of a breach of these obligations. Implicitly therefore the term also includes, at a more abstract level, the institutional archetypes, such as 'trustee,' 'beneficiary' and 'trust' that are constituted from the interaction of those rules.

On the other hand trust law, as used here, does not include the rules of instance-specific application, such as the terms of the trust instrument. Nor does the term connote the statutory rules applying to trustees, such as those in the state *Trustee Acts* or the *SIS Act*, notwithstanding the substantive similarity that might exist between those statutory rules and their general law analogues. Indeed it is precisely the relationship between trust law and these other sources of rules that is one of the key issues investigated in this Thesis.

Finally, this Thesis focuses on trust law as developed in Australia. As Justices Kirby[30] and Keane,[31] amongst others, have observed, key elements of trust law have evolved differently in other Common Law jurisdictions.[32] The impact of the divergences can be quite subtle, so references to cases beyond Australia and the United Kingdom have been avoided wherever possible. Likewise, references in this Thesis to commentary based on other jurisdictions have been included only where their findings are directly applicable to the context under consideration here.

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28 *Raby v Ridehalgh* (1855) 7 De GM &G 104; 44 ER 41; *Knox v MacKinnon* (1888) 13 App Cas 753.

29 *Charitable Corporation v Sutton* (1742) 2 Atk 400, 26 ER 642; *Speight v Gaunt* (1883) 22 Ch D 727. See further Part 5.3 below.

30 Justice Kirby's views on the 'isolationism' of Australian equitable doctrine were expounded, extra-curially in his 2008 WA Lee Equity Lecture, reprinted as Hon. Justice Michael Kirby, 'Equity's Australian Isolationism' (2008) 8 *Queensland University of Technology Law and Justice Journal* 444.

31 Justice Keane responded to Justice Kirby's comments in the 2009 WA Lee lecture: P A Keane, 'The Conscience of Equity' (2010) 84 *Australian Law Journal* 92.

32 The term 'fiduciary' is particularly troublesome in this regard with doctrinal developments in the US, in Canada and in New Zealand imbuing that term with connotations not always present in Australian law. See for instance *Harris v Digital Pulse Pty Ltd* [2003] NSWCA 10, [31] (Spigelman CJ); *Thorpe (No 3)* (1997) 144 ALR 677, 689 (Kirby J). See also Mathew Conaglen, *Fiduciary Loyalty. Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010), 24-26.

Superannuation funds as trusts

A second threshold issue for this Thesis is whether trust law applies in any meaningful way to superannuation funds. No one seriously doubts that superannuation funds are trusts in a strict sense. They are almost always formally constituted as trusts.[33] Even if it were ambiguous, superannuation funds have the key indicia of trusts;[34] a trustee, trust property, beneficiaries and a correlative set of obligations and rights annexed to the property.

There are, however, a number of commentators who have suggested that superannuation funds are different; that they are a new genus of trust, or are in some ways *sui generis* with respect to other members of the class of institutions carrying the title 'trust.'[35] Those propositions, if accepted at face value, would complicate and undermine the argument advanced in this Thesis that trust law, as a set of rules of general application to trusts, makes a contribution to the regulatory scheme governing the superannuation system.

There are several grounds for resisting these propositions, or at least to read down the extent to which they challenge the claim that trust law is relevant to superannuation funds.

The first is that although it is true that superannuation funds have certain differentiating features,[36] the same could be said of many modern applications of the trust model. As Bryan notes:

> The commercial objectives to which the trust can be harnessed are so various, and the ensuing structures so complex, that they might be thought to defy any kind of summary or rationalisation.[37]

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33 *CARE v Bishop* (Unreported, Federal Court of Australia, Northrop J, 31 July 1997). As noted in Chapter 1, the exceptions are Retirement Savings Accounts and the superannuation arrangements for certain public sector employees.

34 Heydon and Leeming, above n 6, [104] – [110].

35 See, for instance, Milner, above n 22; Charaneka, above n 22; Hayton, above n 22.

36 Law Reform Commission, *Superannuation*, [9.7].

Nor are the references to the differentiability of superannuation funds unique. Similar appeals to the relevance of context are familiar in respect of charities[38] and corporate finance,[39] for instance.

The second, and more compelling, reason is that although the courts have on occasion recognised the features differentiating the superannuation fund from other types of trust,[40] this recognition has been accommodated within trust law modes of reasoning. This is well illustrated by three cases that are discussed in more detail in Chapter 8: *Dillon v Burns Philp Finance Ltd*,[41] *Sayseng v Kellogg Superannuation Pty Ltd*[42] and *Vidovic v Email Superannuation*.[43] In each of these cases Bryson J expressed reservations about the wisdom of applying traditional trust principles to superannuation funds. Ultimately, however, on each occasion his Honour felt compelled to apply traditional trust law principles to the circumstances before him.[44]

Indeed the common feature of all but one of the superannuation and pensions cases described in this Thesis[45] is that the courts have employed traditional trust law

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37 Michael Bryan, 'Reflections on some commercial applications of the trust' in Ian Ramsay (ed), *Key Developments in Corporate Law and Trusts Law* (LexisNexis Butterworths, 2002), 205.

38 See for instance *Trustees of the British Museum v A-G* [1984] 1 WLR 418.

39 For a description of the way in which the courts' approach to the highly specialised and distinctive type of arrangement known as Quistclose trusts can be adequately explained using orthodox trust law principles, see Heydon and Leeming, above n 6, [215].

40 In addition to those discussed below see *Gilberg v Stevedoring Employees Retirement Fund Pty Ltd* [2008] NSWSC 1318, [18] (McDougall J); *Tuftevski v Total Risks Management Pty Ltd* [2009] NSWSC 315, [128] (Smart AJ); *Minehan v AGL Employees Superannuation Pty Ltd* (1998) 134 ACTR 1, 10 (Gallop ACJ); *Telstra Super Pty Ltd v Flegeltaub* (2000) 2 VR 276, 278 (Ormiston JA); *Kowalski v NMAL Staff Superannuation Fund Pty Ltd [No 3]* [2009] FCA 53, [25] (Finn J).

41 (Unreported, Supreme Court of New South Wales, Bryson J, 20 July 1988).

42 [2003] NSWSC 945.

43 (Unreported, Supreme Court of New South Wales, Bryson J, 3 March 1995).

44 *Dillon*, above n 41, 14; *Sayseng v Kellogg Superannuation Pty Ltd* [2003] NSWSC 945, [59]; *Vidovic*, above n 43, 11.

45 *Commissioner of Taxation v Commercial Nominees* (1999) 167 ALR 147. See discussion below.

principles in deciding the cases before them. The courts have not employed new modes of reasoning in reaching their decisions. Nor have they established new criteria for decisions, nor crafted new remedies peculiar to the superannuation context. Almost without exception, the courts have treated the institution before them as a trust and have applied trust law modes of reasoning and criteria for decision to them.

Sometimes the court has even specifically noted that approach.[46] The most frequently cited example of this is Megarry VC's conclusion in *Cowan v Scargill* that:

> I can see no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts. Of course, there are many provisions in pension schemes which are not to be found in private trusts, and to these the general law of trusts will be subordinated. But subject to that, I think that the trusts of pension funds are subject to the same rules as other trusts.[47]

In other cases, the fidelity to trust law modes of reasoning and criteria is implicit.

That is however not necessarily the end of the matter. The courts may not have developed new modes of reasoning or criteria for their decisions, but that does not mean that they have ignored the unique circumstances of superannuation funds altogether. They have had regard for the unique features of the superannuation fund as part of what Lord Wilberforce famously called the 'matrix of fact'[48] which guides curial deliberation.[49] It is in this way that trust law is able to accommodate

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46 For instance *Re Scientific Investment Pension Plan Trusts* [1999] Ch 53*; Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587, 1610 (Warner J); approved by Waddell CJ in Eq in *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593, 602. More recently see *Telstra Super Pty Ltd v Flegeltaub* above n 40*; Stevedoring Employees Retirement Fund Pty Ltd v Gilberg* [2006] FCA 1590, [17] – [23] (MacDougall J at first instance (the appeal considered other issues).

47 *Cowan v Scargill* [1985] 1 Ch 270 290.

48 *Prenn v Simmonds* [1971] 1 WLR 1381.

49 Lord Wilberforce's phrase was employed specifically by Warner J in *Mettoy* above n 46, 537, which reference was in turn cited with approval in Australia in *Lock v Westpac* above n 46, 602 and *Ansett Australia Ground Staff Superannuation Plan v Ansett Australia Ltd* [2002] VSC 576, [214].

the peculiarity of the superannuation context without compromising its fundamental cognitive structure.

An important recent illustration of the orthodox approach

The court's treatment of superannuation funds as trusts is well illustrated in the recent case of *Finch v Telstra*.[50] In that case the High Court of Australia was asked to consider whether a specific decision of a trustee in respect of an application by a member for payment of benefits on the basis of Total and Permanent Invalidity should be set aside. In so doing the court had to consider whether, and to what extent, traditional trust law principles, and most particularly those governing curial review of trustee decisions, applied to superannuation funds.

The judgment of the court articulates at some length the points of distinction possessed by superannuation funds.[51] It even, at one point, offered the observation that:

> different criteria might be thought to apply to the operation of a superannuation fund from those which apply to discretionary decisions made by a trustee holding a power of appointment under a non-superannuation trust.[52]

Ultimately, though, the High Court declined to apply different criteria. It applied traditional trust law reasoning to the circumstances before it. The decision taken by the trustee was characterised not as discretionary (which would have meant it was beyond curial review other than on *Karger v Paul*[53] grounds) but rather as a decision based on a question of fact. The question, properly understood, was whether the appellant satisfied the definition of 'totally and permanently invalid' under the deed.[54] The resolution of that question was a trust duty. As such, the court could, and did, review whether the trustee had performed its duty appropriately.

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50 *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36.

51 Ibid, [32-36].

52 Ibid, [33].

53 [1984] VR 161.

54 *Finch*, above n 50, [30].

The one 'qualification' placed by the High Court on the application of traditional trust law principles was that the trustee's duty to ensure it was properly informed (for instance, by making thorough enquiries) before exercising its discretion was more intense in the superannuation context.[55] However that qualification is easily accommodated within traditional trust law modes of reasoning. It was simply a consequence of the peculiar circumstances, the matrix of fact, of the trust.[56]

Perhaps even more tellingly, the High Court declined to override the decision of the trustee. Rather, it ordered that the decision be returned to the trustee for reconsideration.[57] As Byrne J at first instance had noted, this is the traditional curial response to such defaults by a trustee.[58] However, from a more practical, policy-oriented perspective, it rests uneasily with the court's recognition of the trustee's sustained opposition to the beneficiary's original insurance claim.[59] What confidence could the aggrieved member, Mr Finch, have that the belligerence displayed by the trustee in resisting his claims in the past would be replaced by a more appropriate quality of consideration as a result of the High Court's intervention? A court inclined to treat superannuation funds as special might well have acceded to the submission from the appellant[60] that it craft an alternative remedy rather than return the decision to the trustee. Instead, *Finch* was argued and judged on the basis of trust law, and a traditional trust law remedy was applied.

The one exception in the Anglo-Australian jurisprudence where the court arguably did diverge from orthodox trust principles and reasoning is *Commissioner of Taxation v Commercial Nominees of Australia Ltd*.[61] In that case the High Court affirmed the decision of the Federal Court of Australia and the Administrative Appeals Tribunal that amendments to the trust deed of a superannuation fund that would under

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55 Ibid, [66].

56 Ibid, [32-36].

57 Ibid, [67-68].

58 *Finch v Telstra Super Pty Ltd (No 2)* [2008] VSC 527.

59 *Finch*, above n 50, [42-49].

60 *Ibid,* [67].

61 Above n 45.

normal trust law principles have extinguished the trusts and resettled the assets in new trusts did not in fact have that effect in the case before them. The court held that the entity which derived the taxable income in the year in question was the same entity as that which had incurred losses in previous years. That finding permitted the entity (the superannuation fund of the Miden Group of companies) to carry forward those losses in the calculation of taxable income for the year in question. Had the court found that amendments amounted to a resettlement, as argued by the Tax Commissioner, the offsets would not have been permitted and the superannuation fund would have faced a higher tax bill. Instead, the High Court had regard for the practical realities of a modern superannuation fund including continuous changes amongst the beneficiaries, the assets of the fund, the contributing employers and possibly even the trustee, and found that

> The fund, both before and after the amendments, was administered as a single fund, and *treated in that way by the regulatory authority*.[62] (emphasis added)

The authority of *Commercial Nominees* for the proposition, advanced for instance by Charaneka,[63] that superannuation funds are a different type of trust must however be viewed cautiously. As the text emphasised in the quotation above highlights, the context to be considered here was not merely that of a superannuation fund. The revenue context, and in particular the approach of the Australia Taxation Office as regulator, also had to be considered. Moreover, the High Court was careful to frame its conclusions as at least partly a 'question of statutory construction'[64] of the relevant part of the *Income Tax Assessment Act 1936* (Cth). It is therefore submitted that the recurrent reference to the revenue law context of the decision suggests that the High Court was not intending to suggest that superannuation funds should be treated differently in a wider range of circumstances than that which confronted them in this case.

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[62] Ibid, [36].

[63] Charaneka, above n 22.

[64] Above n 45, [34].

Concluding comments

On the whole, then, suggestions that superannuation funds are a new genus of trust, or are in some ways *sui generis* with respect to other members of the class of trusts, underestimate both the diversity of other institutions within the class of 'trusts' and the unifying effect of Lord Wilberforce's encouragement for courts to have regard for the 'matrix of fact'. As a result, such points of differentiation as exist between superannuation funds and other types of trusts have not inspired the courts to deliberate in ways that disturb the basic conclusion reached in this Thesis that trust law makes an important contribution to the regulatory scheme governing the superannuation system.

2.3 The statutory framework

As was noted in Chapter 1, the superannuation system owes its existence to legislation responding to the public policy concerns of successive Federal governments about the provision of retirement income to an aging population.[65] This genesis has also been used by the government to justify its targeted regulation of the superannuation system.[66]

Superannuation Industry (Supervision) Act 1993

The main legislative instrument governing the superannuation system is the *Superannuation Industry (Supervision) Act* 1993 (‘*SIS Act*’). The *SIS Act* was designed to create ‘an enhanced regulatory environment’[67] more attuned to the needs of a system about to undergo a massive change in scale, both in the assets administered and the number of members, as a result of the *Superannuation Guarantee(Administration) Act 1992* (Cth).

The *SIS Act* is the central piece of legislation in the regulatory scheme. It regulates:

- the activities of trustees of superannuation funds (Parts 2, 2A, 2B, 4, 6, 12, 15 and 17);
- operating standards for superannuation funds (Parts 3, 5, 7, 9, 10, 11, 13, 14, 18, 24, 25A and 26);

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65 It is therefore perhaps somewhat incongruous that the Commonwealth’s powers under the Constitution do not expressly include a power to legislate with respect to the superannuation system. This is true notwithstanding that the superannuation system is closely integrated with and dependent on the income tax system and is expressly an adjunct to the social security system, both of which are distinctly Commonwealth domains. Rather, Commonwealth legislation in respect of the superannuation system is founded constitutionally on a combination of the pensions power (*Australian Constitution*, s 51(xxiii),) and the corporations power (*Australian Constitution,* 51(xx)); Paul Klumpes, ‘Collective Investments’, Research Paper (Companies and Securities Advisory Committee, Australian Law Reform Commission, 1993), 6.2.

66 Dawkins, *Strengthening Super Security.* (1992), 3

67 Senate Select Committee on Superannuation, Parliament of Australia, *Safeguarding Super* (1992), 2.56.

- relations with contracted third parties (Parts 12, 15 and 16);
- public offer of superannuation interests (Part 19);
- the availability of financial assistance from the Superannuation Protection Account (Part 23); and
- the powers of nominated regulatory bodies (Part 25, 27, 28, 29),

It also specifies the sanctions for contravention (Part 21). The *Superannuation Industry (Supervision) Regulations 1994*, made under the *SIS Act*, amplify and provide more detail in certain areas.

A number of provisions found in Parts 6 and 7 of the *SIS Act* are of particular importance to this Thesis. Part 6 contains provisions relating to governing rules of superannuation entities, including (in s 52) a set of covenants implied into the terms of the trust instrument that ensure that certain minimum standards of trustee conduct are enforceable. A number of these covenants are specifically analysed in Chapter 5. Likewise Part 7 contains provisions, such as that related to the statutorily defined ‘purpose’ of a super fund (s 62), that are important in substantiating and illustrating the arguments presented in this Thesis. Other provisions in the *SIS Act* are identified and discussed as required through the Thesis.

Enforcement of the provisions of the *SIS Act* and its regulations is achieved in two key ways. Breaches relating to malfeasance by individuals, including individuals acting as trustees, can give rise to a civil penalty order or, if attended with dishonesty, criminal liability under Part 21 of the *SIS Act*. Other breaches, typically of a less serious nature, can result in the superannuation fund losing its complying fund status,[68] which means it loses its privileged tax status under Part IX of the *Income Tax Assessment Act 1993* (Cth). This would in the first instance impose a financial cost to the fund due to an increase in the tax rate on earnings, but more importantly may require members to transfer assets to another, complying fund. Individuals may also be barred from acting as directors under the *Corporations Act 2001* (Cth) by

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68 *SIS Act*, s45.

virtue of their conduct as the director of a corporate entity acting as a trustee to a superannuation fund (see below).

Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 (Cth) (‘*Choice of Funds Act*’)

The *Choice of Funds Act* amended the *Superannuation Guarantee (Administration) Act* to require employers to make a formal offer to contribute the individual employee’s Superannuation Guarantee amounts to any complying superannuation fund that the employee nominates. This is effected through a standard choice form provided to the employee within 28 days of that employee commencing employment with that employer.[69] If the employee fails to make a nomination, the employer can make the contribution to a fund of its choosing (or the ‘default’ fund under the relevant award). However the *Choice of Funds Act* is designed to ensure that the employee is at least aware of the opportunity to direct their superannuation contributions elsewhere. Failure to provide the standard choice form means that the contributions made by the employer do not qualify for the Superannuation Guarantee.

Other legislation

Superannuation funds operate in a commercial context that causes them to be subject to several other legislative regimes. The major examples are nominated (and briefly outlined) below.

Corporations law

The *Corporations Act* and the other sources of corporate law that surround it are relevant to the superannuation system in two main ways.

First, Chapter 7 of the *Corporations Act* regulates the offering of financial products to the public. An interest in a superannuation fund is encompassed by the definition of a financial product.[70] As such, entities intending to offer interests in a

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69 *Superannuation Guarantee (Administration) Act 1992* (Cth), s 32N.

70 *Corporations Act, s* 764A(g).

superannuation fund to the public must comply both with the requirements under Part 2A of the *SIS Act*, and those under the *Corporations Act*, including the requirement to hold an Australian Financial Services Licence (AFSL)[71] and issue a Product Disclosure Statement (PDS)[72] in relation to the offer.

More important to this Thesis, though, is the fact that most trustees of superannuation funds are constituted as corporations limited by shares or by guarantee. Although corporations acting as trustees for superannuation funds are expressly excluded from Chapter 5D of the *Corporations Act* which governs licensed trustee companies,[73] the interposition of the corporate form nevertheless has manifold implications for the regulatory scheme. One in particular, the impact on the location of accountability within the superannuation fund, is discussed in detail in Part 4.4. Others, such as the consequences flowing from the availability of limited liability for entities acting as trustees, are identified but not subjected to detailed analysis in this Thesis.

Taxation law

Tax law likewise intersects importantly with the superannuation system. Perhaps most crucially, it is responsible for identifying the institution of the superannuation fund as a distinctive entity in the first place. When a fund is identified as a 'complying superannuation fund' then a distinctive regime covering taxation treatment for contributions and member withdrawals and for the investment income of the fund applies.[74]

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71 *Corporations Act*, s 766A(1).

72 *Corporations Act,* s 1012C.

73 *Corporations Act,* s 601RAC(3)(e).

74 *Income Tax Assessment Act 1997*(Cth), Part 3-30.

The Commissioner's interpretation of the definition of ‘Australian superannuation fund’ in s 295 of the *ITAA* for the purposes of qualifying for concessional tax treatment as a complying superannuation fund aligns closely with the functional allocation of responsibility across the superannuation fund described in Part 1.5.[75]

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[75] Tax Ruling TR 2008/9 sets out 3 tests that a fund must satisfy in order to be treated as an ‘Australian superannuation fund’. The second of these, that the central management and control of the fund is "ordinarily" in Australia involves ‘a focus on the who, when and where of the strategic and high level decision making processes and activities of the fund’. These include formulating the investment strategy for the fund, reviewing and updating or varying the fund's investment strategy as well as monitoring and reviewing the performance of the fund's investments, formulating the reserving strategy (if there is one) and determining how the assets of the fund are to be used to fund member benefits. Activities of a ‘more formalistic or administrative nature’ such as the acceptance of contributions that are made on a regular basis, the actual investment of the fund's assets, the fulfillment of administrative duties and the preservation, payment and portability of benefits are not considered part of the central management and control of the fund.

2.4 The objectives conditioning the regulatory scheme

Governmental support for the superannuation system has been accompanied by a desire to impose on the system regulation aimed at securing two 'regulatory' objectives: 'member protection' and 'economic efficiency'. This Part outlines those objectives.

In taking the time it does to examine those familiar catchcries of financial regulation,[76] this Part illustrates a fundamental theme of this Thesis – that analysis of regulation ought to extend beyond (the important) instrumental analysis of rules and participants to consider expressly the values that underpin those choices. As Pearson notes:

> If regulation is about collective goals and a moral community … then the conversations in the regulatory system should involve more than technical discussions about the cost, length or even utility of disclosure documentation and other compliance obligations.[77]

This is an important precursor to the discussion in Chapter 3 about the role of trust law in the regulatory scheme because it highlights that analysis of the contribution made by trust law must encompass not merely the instrumental aspects of that contribution, but also the substantive effect of enrolling trust law in the scheme. The discussion in this Part thus provides context both for the general discussion of the role of trust law that appears in Chapter 3 and the analysis of specific statutory rules in Chapters 4 and 5.

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[76] The juxtaposition of economic efficiency and member (or 'investor') protections is a common one in the regulatory theory related to financial markets. See for instance Barbara Black and Jill Gross, 'The Elusive Balance between Investor Protection and Wealth Creation' (2005) 26 *Pace Law Review* 27.

[77] Gail Pearson, 'Risk and the Consumer in Financial Services Reform' (2006) 28 *Sydney Law Review* 99, 99.

Identifying the 'regulatory' objectives

The regulatory scheme shaping superannuation is centred on the *SIS Act,* including the powers it grants to ASIC and APRA, and the *Regulations* it authorises. The *SIS Act* would therefore seem to be the logical place to try to identify the objectives of the regulatory scheme.

The task appears simple. Section 3(1) of the *SIS Act* provides that its object is to:

> make provision for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts and for their supervision by APRA, ASIC and the Commissioner of Taxation.

In the absence of elaboration in the text of the Act, recourse may be had to relevant extrinsic materials.[78] Helpfully, the language in the materials surrounding the *SIS Act* is surprisingly consistent. So, for instance, the *First Report of the Senate Select Committee on Superannuation*, the recommendations in which formed the basis for the *SIS Act*, sought a regulatory scheme that would:

> promote investor protection and ensure equity between members ... such a regulatory structure should also enhance the efficiency and competitiveness of the industry and contribute to broader economic goals.[79]

This was echoed in the second reading speech given in the House of Representatives on 27 May 1993 by Mr Johns, then Parliamentary Secretary to the Treasurer, quoted at the start of this chapter, that the scheme was designed to:

> give added protection to superannuation savings and to promote a more efficient superannuation industry, while avoiding the imposition of unreasonable supervisory and compliance costs.[80]

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78 For the arguments supporting this assertion see Dimity Kingsford Smith, 'Interpreting the Corporations Law—Purpose, Practical Reasoning and the Public Interest' (1999) 21 *Sydney Law Review* 175.

79 Senate Select Committee, above n 67, [4.1].

80 Commonwealth, *Parliamentary Debates,* House of Representatives, 27 May 1993 (Gary Johns), 1101.

Investor protection (including equity between members) and efficiency (including cost effectiveness) are thus key.

The same message has been replayed many times since. For instance the Parliamentary Joint Committee on Corporations and Financial Services as recently as August 2007, noted:

> The committee strongly endorses the view that the regulatory structure for superannuation should promote a viable industry that encourages fair competition to enable fund members to maximise their retirement savings in as safe and secure environment as possible.[81]

It would be easy to terminate the analysis here. 'Investor protection', like its sibling 'member protection', is a phrase which does not encourage interrogation. Similarly, appeals for 'efficiency' and 'security' are hard to interrogate, much less challenge. Who would not want to support measures that increase member protection or promote efficiency?

However, deeper analysis is necessary. A more nuanced, textured description of both 'efficiency' and 'member protection' is required. It is important also to recognise that the regulatory system cannot always achieve the objectives of member protection and efficiency simultaneously. There is often, if not always, a trade-off to be struck. The statements reproduced above do not allude to that complexity. Nor would one necessarily expect them to. They are essentially political statements serving an instrumental purpose; securing maximum support in the political arena for the legislation under consideration. The remainder of this Part is therefore dedicated towards deriving a more precise understanding of the two regulatory objectives as well as the way, in practice, that the regulatory scheme today reveals the shifts in emphasis between those objectives over the past two decades.

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81 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *The structure and operation of the superannuation industry* (2007).

The economic efficiency objective

The first of the regulatory objectives is that the superannuation system must operate efficiently. That is to say, it must incur as low a cost structure as possible and, given the quantum of assets accumulating within the system, with as few externalities and unintended wealth-distorting effects as possible.[82] These two objectives, cost efficiency and allocative efficiency, are assessed in turn.[83]

The importance of cost efficiency

The issue of costs in the superannuation system has attracted considerable attention in recent years. It was one of the catalysts (along with the fall in member account balances caused by the so-called Global Financial Crisis) for the current policy cycle. When announcing the Cooper Review, the Hon. Nick Sherry MP, noted:

> The [Review] will guide what will be a substantial national project aimed at boosting the retirement savings of all Australians by increasing efficiencies, reducing costs and fees, and in turn lifting long-term rates of return.[84]

A starting point is to note that the cost structure of the superannuation system has both explicit and hidden elements.

Explicit costs

The explicit costs are essentially the fees paid to agents in the system, some of which are expressly identified in the accounts and in disclosure documents as 'fees' and some of which are simply described as costs but are nevertheless a transfer of wealth to an identifiable third party. Investment management, administration, legal

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82 Vince Fitzgerald, 'An Assessment of the Current Superannuation Arrangements' (Information Paper No 44, CEDA, March 1996), 12.

83 This distinction is convenient for the discussion that follows and is not intended to bear theoretical weight. In a strict sense, of course, excessive cost is synonymous with rent extraction and, as such, is a symptom of allocative inefficiency rather than a distinct form of inefficiency.

84 Quoted in Jeremy Cooper, 'Super for Members: A New Paradigm for Australia's Retirement Income System' (2010) 3(2) *Rotman International Journal of Pension Management* 8.

and audit fees are examples of the former; brokerage on securities transactions an example of the latter.

There have been a number of attempts to identify and quantify the level of explicit costs in the system.[85] Bateman and Mitchell, for instance, find that average explicit administrative costs[86] for a defined contribution plan range from perhaps 77bp per annum up to around 155bps per annum. When public sector and retail superannuation funds are included, this range widens to around 50bps (public sector) to 250bps (retail sector).[87] More recent research by researchers at APRA[88] and Deloitte/IFSA[89] broadly confirms the range found by Bateman et al.

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85 Apart from those specifically cited below, see for instance D K Malhotra, R Martin and V Marisetty, 'An Empirical Analysis of Australian Superannuation Fund Expenses' (2004) 7 *Review of Pacific Basin Financial Markets and Policies* 451; Sasha Vidler, 'Superannuation: Choice, Competition and Administrative Cost' (2007) 53 *Journal of Australian Political Economy* 27. For a (somewhat polemical) discussion of the fees and costs associated with superannuation in Australia see Stephen Grenville, 'Fund Managers and Superannuation' (2004) 11 *Agenda* 83. For the practical challenges involved in performing this calculation given the information available in the market, see Wilson Sy and Kevin Liu, 'Investment Performance Ranking by Superannuation Firms' (Working Paper, APRA, 2009).

86 Note this does not include costs incurred within portfolios, such as brokerage and other transactions costs, or the costs incurred in co-mingled funds such as hedge and private equity funds. These costs depend on the investment strategy employed by the fund but can be expected to be material in many cases.

87 Hazel Bateman and Olivia Mitchell, 'New Evidence on Pension Plan Design and Administrative Expenses' (Paper presented at 9th Annual Colloquium of Superannuation Researchers, Centre for Pensions and Superannuation, UNSW, July 2001).

88 Anthony Coleman, Neil Esho and Michelle Wong, 'The impact of agency costs on the investment performance of Australian pension funds' (2006) 5 *Pensions Economics and Finance* 299.

89 Deloitte, *IFSA 2009 International superannuation and pension fund fees*. Available at http://www.fsc.org.au.

Whether these fee levels are 'inefficient' is not obvious. Some level of cost is inevitable. The range reported above spans the range of international experience.[90] It is also possible that some of the differences in costs that are detected in the data reflect differences in product features (most likely in the form of additional services such as advice, or enhanced product features such as daily unit pricing). These possibilities are plausible but untested. In any case, it is beyond the scope of this Thesis to assess whether the regulatory system actually achieves its regulatory aims (in this case minimising costs). The focus is rather on the role played by trust law in the regulatory scheme in impelling the operation of the system towards the achievement of those aims, a question to which this Thesis returns expressly in Chapter 8.

Hidden costs

The superannuation system also gives rise to a variety of hidden costs, key amongst which are agency costs (to the extent these are not explicitly addressed in relevant contracts).[91] These are even harder to quantify than the explicit costs. They represent the loss of utility arising from agents wilfully or inadvertently pursuing strategies that do not accord with their principal's objectives. But agency does not only impose costs. Economic theory suggests that a rational principal will appoint an agent only when the inevitable loss of control is balanced by an expectation on the principal's part that the agent will have skills or other attributes that have an offsetting positive value after the cost of retaining the agent is met. It is the net effect of these two factors that is crucial.

90 Hazel Bateman, 'Management of Occupational Defined Contribution Pension Schemes: Lessons from the Administrative Cost Literature' in OECD, *Regulating Private Pension Schemes. Trends and Challenges – No 4* (OECD, 2002).

91 Michael Drew and Jon Stanford, 'Principal and Agent Problems in Superannuation Funds' (2003) 36(1) *Australian Economic Review* 98.

The importance of allocative efficiency

The size of the monies accumulated within superannuation funds poses issues for the efficiency and health of Australia's capital markets and, ultimately, its economy. At present the assets of superannuation funds amount to some $1.3tr,[92] the largest accumulation of financial assets in the Australian economy. Treasury estimates currently have this number growing to around $2.8 tr in 2020 and over $5.0 tr in 2030 (all in nominal dollars).[93]

Irrespective of whether these estimates prove to be realised precisely, it is clear that the way in which this asset base is invested has the potential to distort the process of capital allocation in the economy.[94] Such putative distortions would, in the first instance, affect the distribution of wealth in favour of those able to attract investment from superannuation funds, and away from those unable to do so. Perhaps more importantly, market distortions have the potential to change not just the distribution of wealth but also its total magnitude. Examples of potential market distortions of that type include; home country bias in investment strategies that see the prices of local assets set inefficiently,[95] pursuit of projects whose expected return on capital is increasingly lower as a result of an excess supply of investable capital,[96] sub-optimal behaviour deriving from the principal-agent dynamics inherent in

92 APRA, *Annual Superannuation Bulletin* (December 2011).

93 George Rothman and David Tellis, 'Projecting the Distributions of Superannuation Flows and Assets' (Paper presented to 16th Colloquium of Superannuation Researchers, July 2008, Centre for Pensions and Superannuation, UNSW).

94 Malcolm Edey and John Simon, 'Australia's Retirement Income Stream: Implications for Saving and Capital Markets' (Discussion Paper No 9603, Reserve Bank of Australia, 1996). See also Philip Davis, *Pension Funds: Retirement-Income Security and Capital Markets. An International Perspective.* (Clarendon Press, 1995), Ch 7.

95 See for instance Helmut Reisen 'Liberalizing Foreign Investments by Pension Funds: Positive and Normative Aspects' (Development Centre Working Paper No. 120, OECD, 1997).

96 This can be recast in macro-economic terms as a 'Ricardian' crisis caused by inadequate growth in factor productivity; Dick Bryan, 'Superannuation; the Ricardian Crisis' (2007) 53 *Journal of Australian Political Economy* 100.

delegated investment management[97] and a mismatch between investor time-horizon and economic optimality, such as might occur if trustees were overly conservative[98] or (arguably) ignored "sustainability" issues.[99] Concerns have also been voiced over the suitability of superannuation funds for certain types of capital formation, such as small business finance[100] and venture capital.[101] In each of these cases, the pace of growth of the Australian economy could potentially be impeded by distortions introduced by the investment practices applied to the assets in the superannuation system.[102]

A variety of regulatory strategies exist to address these possible threats. Successive governments have resisted calls for greater regulation of superannuation fund investment strategies and behaviour to address perceived problems such as those

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97 On herding, see for instance Philip Davis and Ben Steil, *Institutional Investors*, (MIT Press, 2001), 259 and, specifically in the UK, David Blake, Bruce N Lehmann and Allan Timmermann, 'Performance Clustering and Incentives in the UK Pension Fund Industry' (1998) 3 *Journal of Asset Management* 17. On tournament behaviour specifically in the Australian context see Terrence Hallahan and Robert Faff, 'Tournament behaviour in Australian superannuation funds: A non-parametric analysis' (2009) 19 *Global Finance Journal* 19.

98 Senate Select Committee on Superannuation, Parliament of Australia, *Investment of Australia's Superannuation Savings* (1996), Ch.6.

99 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate responsibility: managing risk and creating value*, (June 2006). Also James Hawley and Andrew Williams, *The Rise of Fiduciary Capitalism*, (University of Pennsylvania Press,2000).

100 See for instance John Thom, 'Capital formation friction' in Kevin Davis and Ian Harper (eds), *Superannuation and the Australian Financial System* (Allen and Unwin, 1992).

101 Senate Select Committee, above n 98, Ch 4.

102 Piggott is one of very few commentators to have identified that the direction of a portion of national savings towards financial markets via superannuation funds (rather than into further residential property investment as might have been the alternative) is a positive, countervailing (though unquantifiable) factor; John Piggott, 'Comment' in Martin Feldstein (ed), *Privatizing Social Security* (University of Chicago Press, 1998), 93.

listed above.[103] They have preferred instead to rely on the 'market' (by which in practice is meant the interplay of trustee decision-making with market pricing signals) to address possible distortions. Trustees are thus enrolled, perhaps unwittingly, in the pursuit of the economic efficiency objective.[104] The way that the regulatory scheme, and trust law in particular, responds to this objective is described and analysed in Chapter 8.

The 'member protection' objective

The second of the regulatory objectives present in the political rhetoric is 'member protection'. At one level, it is uncontestable. It is hard to sustain an argument that individuals who are forced to contribute financially to a system, and whose access to those financial resources are 'preserved' (ie substantially impeded) until they have reached retirement age, should not enjoy some form of 'protection'. The need to offer 'member protection' is thus a recurring refrain in the political rhetoric of the past two decades.[105]

Beneath this veneer of consensus lie some important differences, however. In particular, nuances emerge when the analysis is refined further to questions such as 'protection from what?', 'effected by whom?' and 'with what consequence?'

The term 'member protection' implies a shift of risk away from members in some respect. The extent to which a regulatory scheme promotes 'member protection' at

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103 For instance, the issue of directed investing was specifically addressed (and rejected) in Dawkins, *Strengthening Super Security* (1992), 3; Senate Select Committee, above n 98. Non-intervention by government was also recently endorsed by the Cooper Review; Cooper Review, *Final Report - Part One: Overview and Recommendations* (July 2010), 4.

104 Dawkins, *Strengthening Super Security* (1992), 10 - 11.

105 See for instance Minister's Introduction in *Options for Improving the Safety of Superannuation*; Issues Paper, 2001, iii. Also Commonwealth of Australia, Financial Systems Inquiry, *Final Report* (March 1997), 193. Apart from the imposition of specific rules by stature, this priority also influences the intensity of focus expected by Parliament of its appointed regulators, such as APRA and ASIC; Superannuation Working Group, *Options for Improving the Safety of Superannuation, Issues Paper* (2001), 2.

any point in time thus depends on how its various elements re-distribute risk across participants in the system.

As we shall see in the chapters that follow, there are few, if any, places in which the superannuation system results in a risk being shared. In some circumstances the superannuation system makes the trustee of the fund accountable to make good a particular shortfall; in other circumstances the member must bear the risk; and in others the government may make good the shortfall. But seldom is there a situation where, as for instance in the payment of an excess when making an insurance claim, the financial burden is shared.

Member protection is thus not a monotonic notion (more or less member protection on same graduated scale). Rather the regulatory scheme may be more inclined to shift certain types of risk that arise in the superannuation system than others. More protection is available to victims of fraud[106] and to participants whose employer has become insolvent[107] than to individuals who made poor investment choices, for instance.

It is also clear that individuals *qua* members, will bear at least some risk. The government has repeatedly stressed that it does not guarantee that the superannuation system will deliver the financial means to assure every individual participant enjoys a dignified retirement.[108] So, for instance, the Australian government has also not followed the lead of some other countries and established a fund to guarantee the entitlements of members of defined benefits schemes found (usually upon the insolvency of the contributing employer) to be underfunded.[109]

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106 Under Part 23 of the *SIS Act* a trustee can apply to the government for ‘financial assistance’ to cover a loss ‘suffered by the fund as a result of fraudulent conduct or theft’ where the loss has ‘caused substantial diminution of the fund leading to difficulties in the payment of benefits’.

107 For instance s 556(1) of the *Corporations Act 2001* (Cth) gives employees priority over most other unsecured creditors in respect of unpaid superannuation.

108 See for instance, Superannuation Working Group, above n 105, 44.

109 Shauna Ferris, ‘Broken promises: solvency issues for defined benefit superannuation funds’ (2006) 5 *Law, Probability and Risk* 201. But cf, the government has recently

In the Chapters that follow therefore, there is recurrent attention to the location of accountability, and the conditions attached to that accountability, achieved by the rules under consideration. It is only through close attention to the effect of the rules, stripped of any of the sentiment that the language might imply, that an overall assessment of the quality of member protection provided by the system can be derived.

Finally, it should briefly be noted that the regulatory system enrols a variety of actors in the provision of these protections, beyond the trustees and the statutory regulators. There is a wider network of private and public sector entities that contribute to this objective, including the SCT (see below), auditors and actuaries, as well as industry associations and even the Australian Accounting Standards Board.[110] Thus the question of where responsibility, accountability and risk lie is not simply a matter of an allocation between trustee and member, other actors contribute to the regulatory system in ways that affect the allocation and are themselves candidates for the allocation of certain responsibilities and accountabilities.

Balancing the regulatory objectives

This Thesis is not concerned with the underlying dynamics of the policy cycles affecting superannuation. It recognises that complex interactions often underlie the policy process in a modern democratic polity. Hence it does not attempt to ascribe ‘motivations’[111] to the government actions that bring about changes to the

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announced an intention to establish such a fund; Marcus Priest, ‘Bid to protect employee super’ *Australian Financial Review*, 26 July 2010, 12.

110 Some of these are examples of what Coffee has famously termed ‘gatekeepers’, but as can be seen from the examples cited above, the list under contemplation here extends beyond that class of actors; John Coffee, *Gatekeepers. The Professions and Corporate Governance* (Oxford, 2006).

111 This is different from the distinction Baldwin and Cave make between the ‘motive for regulating’ and the ‘technical justification’ for regulating which, with respect, is a semantic device that disguises the normative content of the ‘technical’ justifications; Robert Baldwin and Martin Cave, *Understanding Regulation. Theory, Strategy and Practice* (OUP, 1999), 9.

regulatory scheme. However as Donald[112] describes in detail, successive policy meso-cycles[113] relating to the superannuation system have manifested differences in the relative weight accorded to the economic and member protection objectives.

So for instance, the meso-cycle leading to the enactment of the *SIS Act* in 1993 relied heavily on the trust model, in which member protection is effected through a paternalistic, trustee-centred model of accountability.[114] Promotion of the economic efficiency objective was at best implicit.[115]

In contrast, the meso-cycle starting with the Wallis Committee Report of 1996[116] placed a greater emphasis on economic efficiency, and on the modality of consumer sovereignty as a means by which that could be promoted. This was a fundamentally different attitude to the superannuation system than that which had prevailed since the *SIS Act*.[117]

Finally, the (unfinished) process of reform starting with the Cooper review[118] represents a shift back from the economic rationalism of the Wallis approach

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112 Scott Donald, 'What's in a Name? Examining the Consequences of Inter-legality in Australia's Superannuation System' (2011) 33 *Sydney Law Review* 295.

113 The term 'meso-cycle' is here used to connote processes that are shorter than the sustained government support for the superannuation system, but of broader impact than the more or less continuous process of incremental rule formation and interpretation inevitable in a modern regulatory state.

114 Donald, above n 112, 299.

115 Chapter 8 describes the ways in which trust law accommodates, even if it does not expressly promote, the pursuit of economic efficiency.

116 Commonwealth of Australia, Financial Systems Inquiry, *Terms of Reference* (1996). The legislative programme inspired by the Wallis Committee included *Australian Securities and Investments Commission Act 1998* (Cth) (which established ASIC), the *Australian Prudential Regulation Authority Act 1998* (Cth) (which established APRA), the *Financial Services Review Act 2002* (Cth), the *Superannuation Safety Amendment Act 2003* (Cth) ('*Super Safety Act*') and the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* (Cth) ('*Choice of Funds Act*').

117 Scott Donald, 'The prudent eunuch: Superannuation trusteeship and member investment choice' (2008) 19 *Journal of Business and Finance Law and Practice* 5.

118 Super System Review, *Review into the Governance, Efficiency, Operation and Structure of the Superannuation System*. The proceedings and publications of the

towards the paternalism of the trust model.[119] This is particularly evident in the use of the Choice Architecture model.[120] In that model the default position (termed MySuper) for members is similar to the paternalistic model originally embedded in the *SIS Act*. Members can however choose to step out of the MySuper environment in which member protection is emphasised and into a less regulated environment in which competition and choice are given freer rein.[121]

To some extent this waxing and waning in the relative importance of the different objectives is inevitable. The objectives compete. Emphasising one objective, to some extent and in certain respects, necessarily prejudices pursuit of the other. Pursuit of economic efficiency means almost inevitably that some individuals will 'fail' as the system weeds out inefficient practices, products and institutions. On the other hand, the measures required to protect members may impose costs or distort risk-taking (for instance by creating moral hazard). Thus although the political rhetoric may evince a commitment to the pursuit of both objectives, the statutory initiatives emanating from the policy cycles betray a more compromised reality.

The effect of inertia

It is also important to recognise that despite the policy changes, the regulatory scheme exhibits inertia. The statutory initiatives resulting from successive meso-cycles have for the most part been imposed on the *SIS Act* with little regard for the fundamental differences in ideology and regulatory strategy that underlie the changes. The dissonance between the trustee licensing regime found in Part 2A of the *SIS Act* and the private law notion of trusteeship (in which anyone capable of holding and dealing with property can be a trustee)[122] is but one example.[123]

Review are available at www.supersystemreview.gov.au. The government's response can be found at www.strongersuper.treasury.gov.au.

119 Cooper Review, *Final Report: Part One*, 8-10.

120 Cooper Review, *Final Report: Part Two*, Chapter 1.

121 Cooper Review, *Final Report: Part One*, Principle 4, 10.

122 For a discussion see Gino Dal Pont, *Equity and Trusts in Australia* (Lawbook Company, 5th ed, 2011) [21.05].

Another is the set of statutory provisions related to member investment choice, discussed in detail in Part 5.4 below.

The result, today, is a regulatory scheme in which there are identifiable outcrops of rules that appear inconsistent with the surrounding regulatory landscape. These inconsistencies and discontinuities create regions of uncertainty for trustees, members and even regulators. They reduce the cohesiveness of the regulatory scheme and undermine its motive force.

A number of the recommendations contained in Chapter 9 are directed towards the resolution of such inconsistencies.

Concluding comments

The political statements reported in this Part demonstrate the overarching importance accorded to economic efficiency and the security of member interests in the design of the regulatory scheme. However the political statements do not provide much assistance in identifying how these competing objectives are balanced at any point in time; especially in light of the path-dependent nature of the evolution of the regulatory scheme. That must be inferred from the increasingly complex set of statutory rules that are imposed on the system.

It is not the purpose of this Thesis to express a preference for member protection or economic efficiency, nor to suggest an ideal balance between the two. This Part has however introduced the idea that the regulatory scheme embodies these values, unevenly in places and at times in ways that are inconsistent. This analysis forms a backdrop for the analysis in Chapter 8 that maps how trust law contributes to the achievement of the two regulatory objectives and for the recommendations for reform in Chapter 9.

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[123] The ‘fit and proper’ requirement in the licensing regime is not only unusual from a trust law perspective, as the Cooper review noted it introduces an additional layer of complexity into the regulation of trustee conduct; Cooper Review, *Final Report: Part Two*, 45. This is discussed further in Part 5.3 below.

2.5 Mechanisms of Enforcement

This Thesis focuses almost entirely on the rules that in combination constitute the regulatory scheme. Except to the extent that it argues, in Chapter 7, that trust law projects itself normatively onto the expectations and behaviours of system participants, it does not attempt to analyse in any detail the issues that arise from the enforcement of those rules. This Part, then, merely introduces in summary form the main mechanisms of enforcement present in the system as background to understanding the role of trust law in the regulatory scheme.

The use of the trust as the legal infrastructure for superannuation funds means that the courts remain an important mechanism for the enforcement of obligations owed in the superannuation system. Moreover, as we shall see in Chapters 3 – 8, curial deliberations on the content of those obligations and on the content of analogous obligations owed elsewhere under trust law crucially influence the way that the regulatory scheme is understood and implemented. So the role of the court extends beyond the comparatively small number of cases relating to superannuation that are heard each year.[124]

The regulatory scheme provides additional mechanisms for enforcement. Regulatory supervision of the superannuation system is undertaken (predominantly) by three bodies: the Australian Prudential Regulation Agency ('APRA'), the Australian Securities and Investments Commission ('ASIC') and the Australian Taxation Office ('ATO').[125] Their respective roles are briefly discussed below. The role of the

124 Indeed only three cases relating to trustee duties and/or members' interests have come before the High Court of Australia since the introduction of the current regulatory regime in 1993; *Cook v Benson* (2003) 198 ALR 218, *Alexander v Perpetual Trustees WA* (2004) 204 ALR 417 and *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36. As will be seen in later chapters, more have come before State Supreme Courts, but few (other than the three listed above) have been considered in the appellate jurisdiction.

125 Other public sector bodies playing a role include AUSTRAC (in respect of money laundering), the Australian Federal Police (in respect of criminal activity such as identity and other fraud) and the ACCC (in respect of collusive or anti-competitive behaviour on the part of market participants).

Superannuation Complaints Tribunal, a Commonwealth tribunal established as an expeditious, low-cost mechanism for resolving the claims of superannuation fund members against their trustee, is also outlined.

Australian Prudential Regulation Agency ('APRA')

APRA is the most important regulator in the superannuation system.[126] The *Australian Prudential Regulation Authority Act 1988* (Cth) ('*APRA Act*') provides that APRA exists, *inter alia*, to:

> [regulate] bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards[127]

It also provides that:

> In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.[128]

APRA is thus the body responsible for overseeing the licensing regime applied to superannuation entities and the compliance of fund trustees with their obligations under the *SIS Act*.

APRA employs a risk-based and principles-based approach to supervision of the superannuation system.[129] This is consistent with its approach in the banking and insurance sectors. The approach is also consistent with the evolution, perhaps

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126 A more comprehensive description of APRA's approach than in is possible here can be found in Greg Burner, 'Private Pensions Supervisory Methods in Australia' in *Supervising Private Pensions. Institutions and Methods*. (Private Pensions Series No 6, OECD, 2004).

127 *APRA Act*, s 8(1)(a).

128 *APRA Act*, s 8(2).

129 APRA, *The APRA Supervision Blueprint* (January 2010. See also John Ashcroft and Fiona Stewart, 'Managing and Supervising Risks in Defined Contribution Pension Systems' (Working Paper No 12, IOPS, October 2010), [126]; Julia Black, 'Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority' (2006) 28 *Law and Policy* 1.

punctuated by the global financial crisis, towards such an approach in markets around the world.[130]

APRA also issues guidance notes on a range of prudential matters.[131] These documents do not have the force of law.[132] They do however provide guidance on how APRA interprets the relevant aspects of the regulatory scheme and hence on the standards and principles that APRA applies in its supervisory activities.

APRA also has limited enforcement powers.[133] The most important of these are the ability of APRA to disqualify the trustee under the trustee licensing regime under Part 2A of the *SIS Act,*[134] to replace the trustee under Part 17 of the *SIS Act* and to remove the fund's complying fund status under Part 5 of the *SIS Act*. However APRA also has the power, under s289 of the *SIS Act*, to approach the court for an order requiring an individual to comply with a requirement of the *SIS Act*, and under s298 to bring a civil action on behalf of an individual for recovery of loss due to:

> fraud, negligence, default, breach of duty, or other misconduct, committed in connection with a matter to which [APRA has conducted an] ... investigation or examination.

Finally, APRA does not currently have standards making powers with respect to the superannuation industry. However the government has recently announced an intention to extend APRA's powers with respect to the superannuation system to

130 See for instance Christie Ford, 'Principles-Based Securities Regulation in the Wake of the Global Financial Crisis' (2010) 55 *McGill Law Journal* 257; Joanna Gray, 'What Next for Risk-based Financial Regulation?' in Ian MacNeil and Justin O'Brien (eds), *The Future of Financial Regulation* (Hart Publishing, 2010).

131 The current list comprises prudential guidance notes on capital, risk management, adequacy of resources, fitness and propriety, pandemic planning and risk management and management of security risk in information and IT, as well as a note (not being a prudential note) on outsourcing. These are available at <www.apra.gov.au>.

132 A disclaimer to this effect appears on the relevant webpage on the APRA site and at the start of each prudential practice guide; <www.apra.gov.au>.

133 APRA, *2011 Annual Report*, 31.

134 In July 2008 APRA's powers to disqualify individuals from holding a senior role in supervised institutions were passed to the Federal Court.

include the power to make prudential standards.[135] This has the potential to significantly alter the way in which key elements of the regulatory scheme interact and, in particular, could see large areas of trust law eclipsed by delegated legislation in the form of prudential standards.

Australian Securities and Investments Commission ('ASIC')

ASIC's role with respect to the superannuation system has two key elements, both of which flow from the interaction of the superannuation system with the *Corporations Act*. Part 7 of that Act regulates the offer of financial products, including interests in a superannuation fund, to the public. The practical operation of superannuation funds can also give rise to *Corporations Act* issues in areas such as directors' duties and market integrity issues such as insider dealing and the rules relating to takeovers. The effect of the overlap between the regulation of directors' duties and the obligations of superannuation trustees is examined in detail in Chapter 4 below.

Australian Taxation Office ('ATO')

The ATO is the primary regulator in respect of self-managed superannuation funds (SMSFs). These funds are outside the scope of this Thesis. The ATO's regulatory role in respect of the parts of the superannuation system that are covered by this Thesis is thus limited to those infrequent circumstances where contravention of the *SIS Act* by a trustee results in it losing its 'complying' status.

Superannuation Complaints Tribunal ('SCT')

The SCT was established by the *Superannuation (Resolution of Complaints) Act 1993* (Cth) ('*SRC Act*'). It was intended as an alternative to a court system the processes of which had been described by one governmental enquiry as 'costly, time-consuming and often distressing'[136] in relation to superannuation matters.[137] It has become an

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[135] See Commonwealth of Australia, *Stronger Super* (December 2010), 60.

[136] Senate Select Committee on Superannuation, Parliament of Australia, *Safeguarding Super* (1992), 142.

[137] Section s 19A of the *SRC Act* requires the complainant to seek resolution of the complaint with the fund's internal dispute resolution system before applying to the

important avenue for individual members to enforce their rights against superannuation fund trustees.

The *SRC Act* grants jurisdiction to the SCT to provide 'fair, economical, informal and quick' mechanisms for the resolution of complaints by beneficiaries about trustee decisions.[138] It is not bound by technicalities, legal forms or rules of evidence,[139] and parties are typically not legally represented.[140] The SCT may affirm, vary, set aside or substitute its own decision for that of the trustee, or remit the complaint to the trustee or other relevant decision-maker for reconsideration.[141] It cannot award damages or costs. Decisions of the SCT have no value as precedent either in the SCT or in the court system but can be appealed in the Federal Court of Australia.[142]

Trustee decisions can be challenged on the grounds that they were 'unfair, unreasonable or beyond power.'[143] More complex matters are to continue to be dealt with in the court system. There is also a range of issues expressly excluded from the SCT's jurisdiction, the most important of which are those relating to the 'management of the fund as a whole.'[144] These would include decisions relating to the appointment of agents (such as an investment manager or custodian) and the design of an investment strategy for the fund.

Tribunal and s 20 provides that the Tribunal cannot hear a complaint that is already the subject of legal proceedings.

138 *SRC Act*, s 11.

139 *SRC Act*, s 36.

140 The SCT website notes that legal representation is available only at the discretion of the tribunal and that applicants will have to show cause why they should be legally represented; www.sct.gov.au.

141 *SRC Act*, Part 6, Div 3.

142 *SRC Act*, s 46.

143 Second reading speech by Mr Johns, Parliamentary Secretary to the Treasurer, cited in Carol Foley 'The Role of the Superannuation Complaints Tribunal' in S. Kneebone (ed.), *Administrative law and the rule of law: still part of the same package*? (Australian Institute of Administrative Law, 1998)

144 *SRC Act*, ss 14(6), 15F(4) and 15J(4).

Notwithstanding occasional criticisms and challenges, [145] the SCT is widely regarded as being an effective and pragmatic solution to some, at least, of the 'distress' identified by the Senate Select Committee in 1992.[146]

145 For instance in 1998-9 it survived a Constitutional challenge that asserted that it was exercising a judicial rather than an administrative power in contravention of Chapter III of the Commonwealth Constitution; *Attorney General v Breckler* [1999] 163 ALR 576.

146 See for instance *Cooper Review, Final Report: Part 2*, 235-6.

Chapter 3

The Role of Trust Law in the Regulatory Scheme

'Maintaining the trustee structure is paramount for the sound prudential management of superannuation funds. The trust relationship … provides a simple, strong and flexible structure within which superannuation funds can operate. …there is [moreover] a body of common law that exists around which a principle based regulatory regime can be structured. Where prescription is required or desired this can be achieved by legislating exceptions to the trustees' duty under trust law.'

Association of Superannuation Funds of Australia[1]

Chapter 3 is the heart of this Thesis. Chapters 1 and 2 were important because they set the context for the discussion. They described the superannuation system and the regulatory scheme which exerts so much influence on the shape of the institutions populating the system, and indeed the system itself. Chapters 4 to 8 elaborate, instantiate and illustrate the thesis presented in this chapter, and Chapter 9 provides observations and recommendations that flow from the analysis initiated in this Chapter.

This chapter addresses directly the subject of the Thesis; the role of trust law in the regulatory scheme shaping superannuation. It introduces the idea that the contribution made by trust law to the regulatory scheme has both instrumental and substantive dimensions, and then initiates the description and analysis of those dimensions.

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1 Submission to 2001 Productivity Commission Inquiry: *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation;* cited at 109.

3.1 The 'dimensions' of trust law's contribution

Chapter 2 introduced the idea that trust law is one of the strands of law that contributes to the regulatory scheme shaping the superannuation system. It also noted that the system was 'inter-legal' in the sense that the various strands not only co-exist but rely on each other in ways that are at times quite complex.

One way to untangle that complexity is to recognise that trust law's contribution can be understood, for analytical purposes at least, across two dimensions. These are termed the 'substantive' and 'instrumental' dimensions for the purposes of this Thesis.

The substantive dimension of trust law's contribution is very important. As we shall see, it was influential in 1992 in the choice to retain trust law as the preferred legal infrastructure for the superannuation system. More concretely, trust law makes an important contribution in determining who bears the consequences in any particular set of circumstances for the realisation of an undesirable outcome. That issue, bound up in issues of accountability and the allocation of risk, is the lodestar used in this Thesis to excavate the contribution made by trust law to the substance of the regulatory scheme shaping the superannuation system.

In addition, though, it is important to recognise that the contribution made by trust law to the regulatory scheme has multiple modalities. This is what is meant by the 'instrumental' dimension of trust law's role. Trust law supplies concepts and rules to the regulatory scheme in a variety of ways. Its relationship with the other sources of law is at times symbiotic and at other times reflexive. At other times either trust law or the other source of rules prevails in a much more straightforward manner. This is the second, and in some ways more visible, dimension of the inter-legality referred to above.

To speak, then, of two 'dimensions' of trust law's contribution is simply to recognise that trust law's contribution to the regulatory scheme can be viewed from two different perspectives; one looking at trust law's substantive contribution, the other at how trust law brings that contribution about.

Finally, it should also be noted that although the two dimensions are presented here as distinct, that is an analytical artifice. Indeed, the distinction between the two dimensions can be quite subtle at times. Perhaps nowhere is this better displayed than in respect of the notion of 'normativity'. As we shall see below, this Thesis employs the term in a very particular way. The problem is that the term 'normative' can be used in two conceptually distinct ways, both of which are relevant to this Thesis. The OED definition of 'normativity' is

> establishing or setting up a norm or standard; deriving from, expressing, or implying a general standard.[2]

There are thus two distinct meanings: the first which relates to the establishment of the norm, the second which relates to the effect of the norm (which as a matter of logic presupposes that the norm is already in existence). Chapter 7 of this Thesis (describing the normative role of trust law) employs the term in the first sense. It maps the way in which trust law inspires standards and patterns of behaviour ('norms') in system participants. That is an instrumental contribution. It refers to the act of inspiration.[3] Unfortunately the question of the substance of the exhortation (the quality or behaviour it is seeking to inspire) satisfies the second limb of the OED definition. So it would be valid, based on the second limb of the OED definition, to talk about the content of the exhortation (to be honest, or careful, for instance) as being 'normative'. In an attempt to avoid confusion in this Thesis, therefore, the term 'substantive' is used here instead of normative to describe this type of contribution.

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[2] *Oxford English Dictionary* (Clarendon, 1991).

[3] This is the way in which Smith, for instance, uses the term: Stephen Smith, 'The Normativity of Private Law' (2011) 31 *Oxford Journal of Legal Studies* 215.

3.2 The substantive dimension of trust law's role

This Thesis argues that trust law's presence in the regulatory scheme injects the priorities and pre-occupations of Equity into that scheme alongside and intermingled with the priorities and pre-occupations underlying the other strands of the regulatory tapestry. Moreover, those 'nobler' qualities attributed to equitable doctrine[4] might act as a counterbalance to the forces of self-interest and competition introduced into the superannuation system by the decision to permit private market participants to administer the system.

As we shall see in Chapter 4, it seems likely that the aura of paternalistic protection inspired by this type of rhetoric was one factor encouraging policy makers in 1992 to endorse the trust structure as the main legal infrastructure upon which to build the superannuation system.[5] This Thesis argues that this confidence was simplistic and naïve. There is no doubt that equitable doctrine, including trust law, manifests concerns of a substantive nature in the way it weighs the relative equities of the parties to a dispute. However the substantive contribution made by trust law is not limited to the set of member-protecting duties imposed on trustees. Rather it is embedded deep in the cognitive structure of the doctrine; in the causes in respect of which equity will intervene and the criteria it will apply when it does. What's more, this substantive contribution is not simply member-protecting. As we shall see in the detailed analysis presented in Chapters 4 to 8, the matrix of accountabilities effected by trust law represents a finetuned balancing of interests that is conditioned in a variety of ways relevant to the superannuation context.

There is of course an extensive literature concerning the moral, substantive or normative (in the second sense noted above) content of equitable doctrine and of trust law. This Thesis does not attempt to engage with that literature across a broad front. The ambition here is more modest. What matters in this Thesis is not why the rules emanating from equitable doctrine are the way they are, or whether they should be different. What matters is what

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4 Lord Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *Law Quarterly Review* 214, 216

5 The other reasons relate to the instrumental attributes of the trust model. These are discussed in Chapter 4 below.

impact the rules supplied by trust law to the regulatory scheme have on the allocation of responsibility (in a number of senses, as discussed below) in the superannuation system. What standards does trust law impose? Which matters does it address and which does it ignore? And, as will be discussed specifically in Chapters 8 and 9, what support exists within trust law for the regulatory objectives identified in Chapter 2?

Implicitly, then, this Thesis relies on a vision of equitable doctrine closer to the empiricism of Finn (in his earlier work)[6] and Thomas,[7] than the inductive theorising of Birks[8] and Smith.[9] That is not to reject the programme for taxonomic rationality of those latter theorists, but simply to recognise that it is beyond the ambitions of this Thesis to review, far less interrogate, the vast literature that seeks to map and analyse the substance of equitable doctrine.

Responsibility, accountability and the substantive effect of trust law

One of the recurrent themes in this Thesis is that of 'accountability.' There is an obvious harmonic resonance between the notion of accountability and the substantive effect of trust law.

One way to investigate this further is to consider two senses of a near-synonym of accountability: 'responsibility.' The two senses echo the distinction between the instrumental and substantive dimensions of trust law's contributions to the regulatory scheme. That is because, as we shall see, trust law does not simply enforce certain qualities of conduct on trustees, its various rules create the office of trustee in the first place. So trust law both locates responsibility and defines it.

Responsibility as empowerment

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6 See for instance Paul Finn, *Fiduciary Obligations* (Law Book Co, 1977). His later work manifests a more inductive spirit. See for instance Paul Finn, 'Public Trust and Public Accountability' (1994) 3 *Griffith Law Review* 224.

7 See for instance Geraint Thomas, *Thomas on Powers* (OUP, 2nd ed, 2012).

8 See for instance Peter Birks, 'The Content of Fiduciary Obligation' (2000) 34 *Israel Law Review* 3.

9 See for instance Lionel Smith, 'Philosophical Foundations of Proprietary Remedies' in R Chambers, C Mitchell, J Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment,* (OUP, 2009).

The first sense of 'responsibility' is what Hart terms 'role-responsibility.'[10] It is concerned with the location of power in the system. As Chapter 4 outlines in detail, the paradigm resulting from trust law (the trust paradigm) identifies the trustee as the locus situ of most of the powers relating to the trust. It places the trustee at the fulcrum of the institution. The trustee is typically empowered to make all key decisions, to exercise the key discretions and to act with respect to the assets held on trust. Moreover that responsibility is unique. It is true that some trusts reserve powers to other parties (including, on occasion, employers)[11] but these are exceptions and require express reservation. No other private party can assert authority over the administration of the trust. The duties owed by the trustee are non-delegable.[12] Nor, with one narrow exception,[13] can beneficiaries direct trustees to act in a particular way.[14] However, as we shall see below, this concentration of power in the hands of the trustee does not mean that the trustee is always held responsible for compensating the trust for a loss incurred by the trust.

Responsibility as accountability

The second sense in which the question of 'responsibility' can be understood employs Hart's notion of 'legal-liability-responsibility'.[15] It directs attention to the question of who bears the consequences for the realisation of an undesirable outcome in a particular set of circumstances. Trust law has a crucial role to play here also, and it is this sense of responsibility, responsibility as accountability, that is such a fundamental component of the substantive dimension of trust law's role.

As was noted in Chapter 2, the regulatory scheme, in effect, articulates a set of rights and obligations that together constitute the 'virtual' institution that is a modern superannuation

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10 HLA Hart, *Punishment and Responsibility: Essays in the Philosophy of Law* (OUP, 1968), 212.

11 See for instance *Imperial Group Pension Trust v Imperial Tobacco* [1991] 2 All ER 597.

12 *Adams v Clifton* (1826) 1 Russ 297; 38 ER 115.

13 The so-called rule in *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282 permits beneficiaries being unanimous, *sui juris* and absolutely entitled to the whole of the estate to call for distribution of the assets and terminate the trust: *CPT Custodian v Commissioner of State Revenue* (2005) 221 ALR 196.

14 *Re Brockbank* [1948] Ch 206.

15 Hart, above n 10, 215.

fund. The rights and obligations are sourced from across the complex tapestry of legal sources present in the regulatory scheme. These rights and obligations together create a web of accountabilities between participants (including but not limited to the members, the trustee and the individuals serving on the Board of the trustee) that governs the management of the institution and, crucially, determines when legal-liability-responsibility will be allocated to one of those participants.

Implicit in this is the fact that the distribution of 'legal-liability-responsibility' across the system is not identical with the distribution of 'role-responsibility.' It might seem that the person empowered to make a decision should bear the consequences if that decision proves improvident; that they should be forced to compensate those adversely affected by their decision and thereby ultimately bear the burden of the shortfall. On closer examination, though, it becomes clear that the regulatory scheme creates a more nuanced matrix of accountabilities than that. As we shall see in later Chapters, there are circumstances when the trustee will be held liable to account for 'losses' incurred by the trust. However that analysis also identifies circumstances where the trustee is responsible in the first sense but trust law (and the regulatory scheme) does not hold it responsible in the second sense.

Trust law, as part of the regulatory scheme, contributes significantly to that conditional reallocation of accountability from the party who is role-responsible (usually the trustee) to the party who is legal-liability-responsible (often, but not always the trustee). That is true notwithstanding that many of the rules supplied by trust law are conditional, in that they apply only to the extent that they are given scope to apply given both the fund's circumstances and the complex interaction between the different strands in the tapestry. Nevertheless, as Chapters 4 to 8 demonstrate, trust law contributes significantly to that re-allocation, directly and indirectly. It significantly influences how the regulatory scheme defines in which circumstances different participants will ultimately bear the consequences for the realisation of an undesirable outcome.

Risk in the superannuation system

The concept of risk plays a large role in many theories of regulation.[16] It is even possible, as Hood et al do, to describe regulation as an activity that 'attempts to control risk' and thereby recast much discussion of regulation in the language of risk.[17]

This Thesis does not take that route. It does however recognise that discussions about the substantive effect of trust law and the location of accountability are often inevitably also about the location and relocation of various types of risk. This will be most evident in Chapters 5 and 8 where the allocation of investment risk between the trustee and fund members is discussed in relation to the duty of trustees to exercise care in the investment of trust assets.

However the resonance is more pervasive than that. Risk is ubiquitous in the superannuation system. From the broadest perspective, it might be said that support for Australia's superannuation system implies that our society deems it undesirable for retired individuals to have inadequate financial resources to fund a dignified life for their non-earning years.[18] That is the 'risk' that the system as a whole addresses. Indeed, sociologists such as Giddens,[19] Ewald[20] and Luhmann[21] have even applied the technology of risk to the social welfare system generally as part of a broader agenda of the 'risk society'.

Risk is also relevant at a local level, most obviously in the operation of superannuation funds and the exposure of the account balances of individual members to the volatility of financial

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16 It is sometimes suggested that risk is not a concept often found in legal theory; Anthony Giddens, 'Risk and Responsibility' (1999) 62 *Modern Law Review* 1, 1. But cf Jenny Steele, *Risks and Legal Theory* (Hart, 2004) who argues that concepts of risk are very much present in legal theory even if they are not always articulated in those terms.

17 For instance Christopher Hood, Henry Rothstein and Robert Baldwin, *The Government of Risk* (OUP, 2001), 3.

18 See for instance, Giddens above n 16, 4.

19 François Ewald, *L'Etat providence* (1986), described in Michael Behrent, 'Accidents Happen: François Ewald, the "Antirevolutionary" Foucault, and the Intellectual Politics of the French Welfare State' (2010) 82 *The Journal of Modern History* 585, 609.

20 Giddens, above n 16, 4, 7, 9.

21 Niklas Luhmann, *Risk: A Sociological Theory*, (de Gruyter, 1993).

markets. However investment risk is not the only type of 'risk' present at a local level. There is the risk of outright fraud by the trustee, by third parties or, less commonly, by members. There is also the risk that members' entitlements will be miscalculated or that employers will not be in a position to contribute what is required of them. There is also agency risk in so far as the trustee, investment manager or other agents of the trustee may pursue private objectives not wholly aligned with those of their underlying 'principals', the members.[22] It is these risks, for the most part, which the regulatory scheme (as a whole, including both private and public strands) seeks to address.

'Risk' is moreover a protean concept.[23] It can refer to the possibility of an undesirable outcome, or to the uncertainty associated with forecasting a single outcome, or to fluctuations (in the sense of market 'volatility') or to the distribution of outcomes across a population. It is not difficult to recognise examples of each of these conceptions of risk in the superannuation system.

It is the first of these conceptions of risk with which we are concerned here.[24] When risk is viewed as the possibility of an undesirable outcome, the harmonic resonance between risk, accountability and the substantive effect of the regulatory scheme becomes clear. Accountability is concerned with the question: who bears the consequences in any particular set of circumstances for the realisation of an undesirable outcome? Risk is concerned with a similar question. It is concerned with who would bear the consequences in any particular set of circumstances for the realisation of an undesirable outcome. It is therefore an *ex ante* analogue of accountability (at least as that term is used here), in which the presence of uncertainty with respect to the future is more expressly articulated.

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22 Michael Drew and Jon Stanford, 'Principal and Agent Problems in Superannuation Funds' (2003) 36 *Australian Economic Review* 98.

23 Scott Donald, 'Risk: An Uncommon Deviation' (2006) *JASSA*, Winter, 26.

24 The other conceptions of risk are of course related to this first conception of risk. Each makes an appearance in the chapters that follow.

3.3 The instrumental dimension of trust law's role

The instrumental dimension of the role played by trust law can be distilled for analytical purposes into four distinct aspects. This distillation provides a structure for the central Chapters (Chapters 4 to 7) of this Thesis. That is not to downplay the importance of the substantive dimension; the substantive implications of the analysis are addressed continuously throughout the Thesis. However the distillation of the instrumental dimension into the four aspects described below has proved to be an effective way of framing and articulating the analysis overall.

The four aspects of the instrumental dimension of the role played by trust law are:

1. Trust law provides an infrastructure for the location of property and other rights in the system. At a conceptual level trust law provides an institutional form, a modality, the trust, that identifies certain roles, trustee and beneficiary key amongst them, and defines those roles in terms of the responsibilities they owe to each other. This infrastructure is implicit in both the *SIS Act* and in APRA's regulatory practices, permitting as it does focus on the trustee as the appropriate subject of regulation. This will be referred to in this Thesis as trust law's **Infrastructure** role.

2. Trust law contributes specialised, meaning-laden vocabulary to the statutory framework. The *SIS Act*, in particular, deliberately employs language drawn directly from trust law. Recent cases demonstrate that the meanings attached to these words and phrases in general law inform curial interpretation of the statutory rules in particular. This will be referred to in this Thesis as trust law's **Interpretive** role.

3. Trust law provides 'default' rules that courts can apply when the statutory and other regulatory rules are found to be deficient or ambiguous. Indeed, the *SIS Act* expressly provides for the continued relevance of other sources of rules, such as trust law, in so far as those rules are not inconsistent with express provisions of the *SIS Act*. These include most notably the fiduciary and other obligations imposed on trustees but can also be relevant in respect of certain fact situations,

such as the division of any surplus funds available upon the winding up of a defined benefit superannuation plan. This will be referred to in this Thesis as trust law's **Default** role.

4. Finally, trust law contributes a vocabulary to discourse in the superannuation system that inspires expectations and behaviour, and ultimately norms, which go beyond the strict letter of the law. These, for the most part, are protective of members' interests and as such represent an important contribution to the regulatory scheme, albeit one that is informal and not enforceable by legal sanction. This will be referred to in this Thesis as trust law's **Normative** role.

These aspects are considered successively in detail in Chapters 4 to 7 below.

Concluding Comments

The conception of the regulatory scheme as an integrated, reflexive and inter-dependent ('inter-legal') tapestry of rules has obvious ramifications for the question at the heart of this Thesis. It hints that the role of trust law is likely to go beyond simply the injection of a finite set of rules into the regulatory scheme or, alternatively, a general impetus towards a paternalistic protection of members. In fact, as has been suggested in this chapter, and will be demonstrated in the chapters to come, the interaction between trust law and the other key strands in the tapestry is richer and more complex than that.

For analytical purposes the contribution made by trust law has been mapped in this Thesis across two dimensions:

- a **substantive dimension** that addresses trust law's role in the regulatory scheme in determining who bears the consequences for the realisation of an undesirable outcome in any particular set of circumstances; and
- an **instrumental dimension** that highlights the variety of ways in which trust law supplies concepts and rules to the regulatory scheme. This has in turn been distilled into four distinct modalities: an infrastructure role, an interpretive role, a default role and a normative role.

Chapters 4 to 7 excavate these propositions in more detail. As was noted above, they are structured around the four modalities of the instrumental dimension as this proves to be a convenient way to consider the roles of individual concepts and roles. Chapter 8, on the other hand, responds specifically to two key substantive concerns of the regulatory scheme; the regulatory objectives of economic efficiency and member protection identified in Chapter 2.

Taken together, those five chapters provide a rich picture of the nuances and complexities present in the tapestry of rules comprising the regulatory scheme shaping the superannuation system. Perhaps more importantly, they illustrate in a very detailed way the inter-legality of the regulatory scheme and thereby uncover the multi-faceted contribution made by trust law to that scheme.

Chapter 4

Trust law's infrastructure role

'Essentially, a superannuation fund is based upon principles of equity… [It] is created by a trust deed under which a fund or other assets are held by a trustee upon the trusts expressed in the trust deed. Persons entitled to the benefits of the trusts commonly are known as members and although members are not parties to the deed they are able to enforce their rights against the trustee by legal proceedings.'

Northrop J in *CARE v Bishop*[1]

The superannuation system requires a legal architecture in which to locate and define the property and other interests of participants. The trust is the legal institution that most commonly plays this role.[2] It provides a legal and institutional modality fundamentally important to both the superannuation system and the regulatory scheme that governs it.

In the early years of the superannuation system this reliance was to a large a consequence of choices made by the parties responsible for establishing the fund, be they the employer, a union or financial institution. However the reforms of 1992-3 have now embedded this reliance on trust within the system to a much greater extent. The *SIS Act* in particular relies very heavily on trust law to provide an institutional architecture (including the trust instrument and the office of trustee).

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1 (Unreported, Federal Court of Australia, Northrop J, 31 July 1997).

2 Law Reform Commission, *Superannuation* (1992), [5.2].

A number of the instrumental features of the trust ‘model’ emerging from trust law generally support this choice. They are described in Part 4.1:

- trust law quarantines the assets from both the sponsoring employer and the employee/member, helping to ensure that the assets are preserved to finance the member’s retirement;
- the location of responsibility for administering the trust in the trustee facilitates administration of both member accounts and the assets of the fund;
- trust law is inherently flexible, and hence able to accommodate variation, differentiation and evolution without losing its fundamental characteristics; and
- the identification of the trustee as the entity responsible for administering the trust focuses accountability (and liability, when required) within the institution.

Notwithstanding these attractions of using trust law, there are aspects of trust law that are inherent in the trust paradigm itself but might be considered shortcomings in respect of this infrastructure role. Two are investigated in detail in this Chapter.

The first is the risk that the flexibility afforded at general law is exploited in ways that undermine the integrity of the system. This risk, and the legislative response it has inspired, is discussed in Part 4.2.

The second potential shortcoming arises not from trust law *per se*, but from the practical application of trust law in the superannuation context. It is the effect of the requirement that trustees of superannuation funds be incorporated. The consequences of this seemingly benign requirement are investigated in Part 4.3.

The overall conclusion reached from the analysis below is that these shortcomings do not outweigh the attractions of using trust law as the blueprint for the institutional structure of a superannuation fund. Moreover the interdependence between statute and trust law outlined in this Chapter is the first of many examples of the way that the different strands of law interlace and interact ‘inter-legalistically’ to achieve the nuanced balancing of interests and priorities sought by policy makers and regulators.

4.1 The trust as 'holding device'

It is axiomatic that a trust locates legal ownership of the assets in the person of the trustee (or trustees), subject to the equitable interests enjoyed by the members of the fund.[3] The nature and content of those equitable interests emerge as a product of the various obligations imposed by the trust instrument and relevant statutory and general law rules on the various participants in the trust.

The trust thus acts as a legal device capable of simultaneously locating property rights and articulating a set of reciprocal obligations owed by the participants in the institution in relation to that property.[4] This is the trust as 'holding device' that is described by Sin in the analogous context of unit trusts.[5]

Historical accident or intelligent design?

It is an empirical fact that most superannuation funds today are structured as trusts.[6] It is however important to recognise that the trust was not the only legal institution that could have been chosen to provide the legal architecture for the superannuation system in 1992. Any one of a number of incorporated, statutory or private forms of association might have been chosen.[7]

To some, the choice of trust law was obvious almost to the point of inevitability. Lord Browne-Wilkinson has for instance observed extra-curially that:

> In common law countries, the trust was the obvious structure to adopt. Superficially, it met all the requirements both fiscal and practical: a separate body of trustees, independent from the employer, holding assets applicable for the benefit of a class of beneficiaries, the members. There was an existing body of detailed law regulating the powers and duties of

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3 *Glenn v Federal Commissioner of Land Tax* (1915) 20 CLR 490.

4 *Re Scott* [1948] SASR 193, 196, (Mayo J).

5 Kam Fan Sin, *The Nature of the Unit Trust*, (Clarendon, 1997), 102.

6 Productivity Commission, *Review of the Superannuation Industry* (2001), 2.4.

7 Indeed prior to reforms to UK tax laws in 1921, most pension plans in that country for civil servants, railway employees and others were constituted as statutory bodies. C G Lewin, *Pensions and Insurance Before 1800; A Social History* (Cromwell, 2003).

> trustees and beneficiaries. Trusts appeared to be self evidently the right machinery to adopt.'[8]

Perhaps it is not surprising therefore that there is little documentary evidence establishing why trust law was in fact chosen as the legal infrastructure for the superannuation system. Indeed two early critics of the choice, Paatsch and Smith, writing contemporaneously with the changes in 1992, reported that:

> the use of the trust vehicle for the management and operation of superannuation schemes has been assumed rather uncritically[9]

Certainly, the Law Reform Commission report that informed the drafting of the *SIS Act*[10] in 1992 received little input on the appropriateness of trust law, despite calling for submissions on the subject.[11] The recent Cooper Review had a similar experience.[12]

It is possible that this lack of engagement with such a fundamental design decision was that until recently[13] there have been few defalcations of superannuation fund assets in Australia whose origins can reasonably be said to be found in shortcomings in the protections afforded by trust law. As the Productivity Commission concluded in its review of the regulatory scheme in 2001,

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8 Lord Browne-Wilkinson, 'Equity and its Relevance to Superannuation Today' (Paper presented at Law Council of Australia Superannuation Conference, Canberra, February 1992), 2.

9 Dean Paatsch and Graham Smith, 'The Regulation of Australian Superannuation: An Industrial Relations Law Perspective. Part 1' (1992) 5 *Corporate and Business Law Journal* 131, 149.

10 Law Reform Commission, *Superannuation* (1992).

11 Ibid, 9.2.

12 Cooper Review, *Preliminary Report*.

13 The total compensation paid by APRA in relation to superannuation fraud over the past ten years is reportedly around $100m, more than half of which related to the Trio Capital scandal in 2010 which saw the government grant financial assistance of approximately $55m to superannuation funds of which Trio was the trustee; <http://www.businessday.com.au/business/inquiry-grills-apra-chiefs-20110830-1jk2v.html>.

> Trusts are perceived widely to be highly suited to, and to have worked well in, ensuring the prudent management of superannuation entities.[14]

Had there been a scandal of the scale of the Maxwell scandal in the UK, the public outcry it would no doubt have inspired might have prompted far greater scrutiny of the decision to rely on trust law.[15] However even the official review in the UK following the Maxwell scandal received a similar underwhelming response to the question of whether the trust structure remained an appropriate vehicle for pension (superannuation) funds.[16]

In the absence, then, of any detailed public discussion of why the trust was chosen, it is possible to point to a number of instrumental features of trusts that support their use as the legal infrastructure for superannuation funds. Each of these features no doubt supported the trust in what Langbein has colourfully described as

> a sort of Darwinian struggle against other modes of business organisation and finance.[17]

1. Quarantining of trust assets

The first advantage of the trust structure is that it ensures that the assets of the superannuation fund are kept identifiably separate from the assets of each of the parties.

The assets of the trust are, for instance, quarantined from the assets of the sponsoring employers.[18] This can be important in the event of the insolvency of the employer, as was

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14 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1. But cf Arie Freiburg 'Bang Bang Maxwell's Silver Hammer? Superannuation Crime in the 1990s' (1996) 24 *Australian Business Law Review* 217.

15 For an account of the demonization of trust law following the Maxwell scandal in the UK see Graham Moffatt, 'Pension Funds: A Fragmentation of Trust Law', (1993) 56 *Modern Law Review* 471; David Hayton, 'Trust Law and Occupational Pension Schemes' [1993] *Conveyancer and Property Lawyer* 283. Also David Blake, 'Pension choices and pensions policy in the United Kingdom' in S. Valdes-Prieto (ed), *The economics of pensions. Principles, policies and international experience* (CUP, 1997), 277; Richard Nobles, *Pensions Employment and the Law* (Clarendon, 1993), 7; Freiberg, above n 14.

16 In the UK see *Report of the Pension Law Review Committee (the Goode Report): fourth report of the Social Security Committee together with the proceedings of the Committee.* (HMSO,1993).

17 John Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107 *Yale Law Journal* 165, 179.

seen in cases such as *Re HIH Superannuation*[19] and *Re Drexel Burnham Lambert.*[20] In these cases the determination of the entitlements of members to the assets in the fund could proceed independently from, and notwithstanding, the insolvency of the employer. Quarantining also helps to ensure that assets contributed to the superannuation system are not available to members except in exceptional circumstances. Those amounts are thereby said to be 'preserved' until retirement.[21] 'Preserving' the monies in this way helps to secure the system's primary objective of providing a means by which individuals will save during their working lives to accumulate assets to fund retirement expenditure.

Finally, the separation of trust assets from both employer and employee (and indeed the trustee's own assets) also facilitates the implementation of the unique taxation environment in and around the superannuation system.

2. Administrative efficiency

Second, because beneficiaries do not have a legal interest in the underlying assets of the trust, use of a trust structure permits changes in membership to occur without the need to adjust continually the ownership interests in the fund corpus.[22] In a co-mingled environment characterised by mandated regular contributions, investment switches, the possibility of pre-retirement drawdowns and payment of retirement benefits, this dramatically decreases the complexity of administering the fund.[23] The fact that almost all superannuation funds (other than SMSFs) have a single incorporated entity as their trustee facilitates this further. An incorporated trustee also provides the institution with perpetual succession, an important consideration given the long-lived responsibilities the trustee

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18 *Australian Prudential Regulation Authority v Holloway* [2000] FCA 1245, [10]; *Olesen v Parker* [2011] FCA 1096, [57]. See more generally Graham Moffatt, *Trusts Law. Text and Materials*, (CUP, 2005), 654.

19 *Re HIH Superannuation* [2003] NSWSC 65.

20 *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32.

21 Note the use of the term 'preservation' in this context is unfortunate in that it might appear to evoke the notion of preservation of capital found in trust law (see Part 5.4 below) and thereby suggest that members should expect that the trustees of their fund have a duty to ensure their balances never fall in value, rather than its narrow, technical meaning.

22 *Commissioner of Taxation v Commercial Nominees* (1999) 167 ALR 147.

23 Moffatt, above n 18, 9.

undertakes in administering members' balances over potentially many decades. However, as we shall see in Part 4.3 below, the use of an incorporated trustee introduces certain undesirable complexities and uncertainties, only some of which are currently addressed by the regulatory scheme.

3. Flexibility

Third, trust law is inherently flexible, and as such capable of accommodating differences in private preferences and circumstances.[24] Trusts are not unique in possessing such flexibility, but this attribute was clearly attractive to policy makers in 1992. For instance the government at the time of the enactment of the *SIS Act* noted:

> In view of the wide diversity of superannuation funds, it is important that there be flexibility in the drafting of deeds to suit the circumstances of individual funds[25]

Flexibility was no doubt important for political reasons in 1992 and 1993 to counteract the tenor of compulsion that accompanied the announcement of the Superannuation Guarantee. It was intended to provide employers, in particular, reassurance that their existing arrangements for employees could be accommodated and serve as a foundation for their future obligations.[26] It also gave the union movement the ability to design institutional structures, such as co-ownership of key service providers and tailored boards, consistent with their broader political and industrial objectives.[27]

More fundamentally, the flexibility inherent in trust law has accommodated the continuous process of differentiation in the processes and structure of superannuation funds that has produced the diversity amongst superannuation funds described in Chapter 1. Seen in this

24 See for instance David Hayton, 'The Uses of Trusts in the Commercial Context', in David Hayton (ed), *Modern International Developments in Trust Law* (Kluwer, 1999), 145.

25 Dawkins, *Strengthening Super Security* (1992), at 9.

26 Ibid, 9.

27 Descriptions of the evolving objectives of the trade union movement with regards superannuation can be found in Paatsch and Smith, above n 9 and Dean Paatsch and Graham Smith, 'The Regulation of Australian Superannuation: An Industrial Relations Law Perspective. Part 2' (1992) 6 *Corporate and Business Law Journal* 29, as well as Diana Olsberg, *Ageing and money* (Allen & Unwin, 1997) and more recently Christine St Anne, *A Super History* (MajorStreet, 2012).

light, the flexibility afforded by trust law is an important precondition for innovation within the system, and as such essential to the pursuit of the economic efficiency objective identified in Part 2.4. This is discussed in more detail in Chapter 8 below where the contribution of trust law to the pursuit of the regulatory objectives is addressed directly.

4. Focussed accountability

Fourth, the trust structure centres responsibility for the administration of the scheme in the hands of a finite and identifiable location; the trustee(s).[28] The trustee in the trust model is the focal point in a web of accountabilities that spreads out in all directions. The same cannot be said, for instance, of corporations, where power is formally distributed between the Board of directors and the shareholders in General Meeting.[29] In a trust, the trustees stand between the beneficiaries, to whom they are accountable for the administration of the trust, and any outsiders with whom they contract or otherwise incur obligations on behalf of the trust.[30] The trustee is vested with the key administrative and dispositive powers associated with the trust,[31] and the concomitant obligations that attach to those powers and responsibilities.

Focused accountability makes trust law attractive for policy makers and regulators in the superannuation context. As the Productivity Commission noted in 2001:

> The focus of the SIS legislation on a sole responsible entity — the trustee — also provides certainty amongst members and to the regulator about who is legally responsible for the

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28 Dawkins, *Strengthening Super Security* (1992), 3.

29 *Automatic Self Cleansing Filter Syndicate v Cunninghame* [1906] 3 Ch 34.

30 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1. In trust law generally, see for instance *Bennett v Wyndham* (1862) 4 De G F & J 259; 45 ER 1183, where the trustees were held liable in tort to a third party when timber that was an asset of the trust was felled, injuring the third party. The trustee was ultimately held to be entitled to exercise their right of indemnity of trust assets to meet the claim, but from the perspective of the plaintiff it was the trustee who was personally liable to pay damages. See also *Re Raybould* [1900] 1 Ch 199.

31 Although important powers can be reserved to parties other than the trustee, as Hayton notes, there is a point at which the reservations impinge so fundamentally on the essence of the trust as to encourage the courts to consider whether the arrangement is in fact a trust at all: David Hayton, 'The Irreducible Core Content of Trusteeship' in A J Oakley (ed), *Trends in Contemporary Trusts Law* (Clarendon, 1996), 56.

> management of contributions and assets, and who will be held liable if anything goes wrong.[32]

It is reinforced by the practical requirement, discussed in more detail below, that the trustees of superannuation funds be incorporated entities. The presence of a single entity acting as trustee (rather than a set of individuals acting as co-trustees) facilitates 'prudential' regulation by making the identification of a 'responsible entity' for each superannuation fund straightforward.[33] It also simplifies the process of data collection and hence regulatory supervision.[34]

The introduction of trustee licensing in 2004 illustrates very effectively how the regulatory system relies on this focused accountability. Trustee licensing gave APRA an enhanced ability to impose a consistent set of competence, integrity and operating standards on entities seeking to act as trustees of superannuation funds.[35] Although no doubt standards could have been imposed on more disparate institutional forms, the placement of the key powers and obligations in a single, central location makes the definition and enforcement of those standards much easier.

5. Inertia

Finally, we should dispose of the argument that trust law was originally chosen because much of the nascent superannuation industry in 1992 was already structured that way.[36]

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32 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1.

33 In contrast, investment unit trusts prior to 1998 were required to have both an investment manager and a trustee, an arrangement that a report into the unlisted property trust crisis of 1991 by the Law Reform Commission found to be unnecessarily complicated and ineffective in protecting investors: Companies and Securities Advisory Committee, Australian Law Reform Commission, *Collective Investments: Other People's Money*, Report No 65 (1993).

34 Ross Clare, 'The shape of things to come: the impact of choice and APRA licensing' (Paper presented at 14th *Annual Colloquium of Superannuation Researchers*, Centre for Pensions and Superannuation, UNSW, July 2006).

35 Ross Jones, 'Living in a Post Licensing World' (Paper presented at ASFA 2006 National Conference, Perth, November 2006).

36 Malcolm Edey and John Simon, 'Australia's Retirement Income System' in Martin Feldstein (ed), *Privatizing Social Security* (University of Chicago Press, 1998), 64.

There is in fact no contemporary documentary evidence to support this claim. There are also several reasons to doubt that inertia, of itself, was determinative. The first is that even in 1992 the projections of money flows into the superannuation system as a result of the SG were sufficient to caution against retention of trust law had there been any misgivings.[37] Indeed the government's primary justification for the *SIS Act* was expressed to be the need to establish a robust regulatory system in anticipation of these massive capital flows.[38] Notably also the portion of superannuation assets held in other types of legal arrangement (such as insurance contract and statutory body) was far greater in 1992 than they are today, so the choice was not as inevitable in 1992 as it might appear today.

Inertia, then, was not a major issue in 1992. As noted above, it may have assuaged employer and employee concerns about how the new compulsory superannuation system would affect existing employment arrangements, but its main effect would seem to have been that it confirmed the practical viability of delivering superannuation benefits through trust structures; a viability that derives from the instrumental attributes identified above.

The same could not be said the next time that the government asked the question, in 2010. Inertia was never expressly identified as a major constraint in the Cooper Review,[39] but the challenge of resettling over $1.3tr in a new legal infrastructure would have been daunting indeed. Indeed the closest the Review came to conceding that inertia might be relevant was obliquely when it noted that it was determined to ensure that its recommendations were 'practicable'.[40] Thus although the fact that the system already founded on trust law may

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37 The system amounted to $183bn in 1993 and was projected to grow tenfold by 2020: Ralph Willis, Treasurer of the Commonwealth of Australia, *Saving for our Future* (AGPS, 1995). The system did in fact amount to $1,305bn by December 2011; APRA, *Quarterly Superannuation Bulletin*, December 2011.

38 Dawkins, *Strengthening Super Security* (1992), 1.

39 See for instance the submissions to the Cooper Review by ASFA, IFSA and FPA: Super System Review, Review into the Governance, Efficiency, Operation and Structure of the Superannuation System; Association of Superannuation Funds of Australia submission of 16 October 2009, 3; Investment and Financial Services Association submission of 25 August 2009, 24; Financial Planning Association submission of 30 October 2009, 3. All available at www.supersystemreview.gov.au.

40 Cooper Review, *Final Report: Part One*, 22.

not have been a binding constraint in 1992, to all intents and purposes it has become one twenty years later.

Concluding comments

It may be impossible to divine unequivocally the precise reasons why the trust structure was chosen in 1992 as the legal architecture for the most important institution in the superannuation system. However, as Moffatt notes in the UK context:

> Whatever the reason for it, the trust has endured and is well established as the primary legal basis for the pension scheme.[41]

That endurance is no fluke. It is no doubt due to the features of the trust noted above; the ability to quarantine assets, to focus accountability and facilitate administration across the institution and, perhaps most importantly, the ability of the trust structure to accommodate diverse and changing circumstances. However, as the remainder of this chapter demonstrates, the choice of trust law means that the regulatory scheme must address two key limitations; the vulnerability of the protections offered at trust law to opportunistic and self-interested drafting of the trust instrument, and the limitations of Commonwealth power under the Constitution to regulate both trusts and superannuation. It is to these limitations, and the legislative measures they have inspired, that we must now turn.

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[41] Above n 18, 655.

4.2 The primacy of the trust instrument

The trust instrument articulates the rules that govern the administration of the trust.[42] It defines precisely the rights, expectations and obligations that define the relationship between the trustee and beneficiaries.[43] Equivalently, the trust instrument delimits the circumstances in which the general principles of trust law apply. It can also, in often subtle ways, condition their application. Thus trust law itself does not establish a definitive balance between the interests of the parties. That balance is struck in the first instance by the terms of the trust instrument, and by the interpretation of that instrument (and any relevant legislation) by the courts.[44]

The starting point, then, for ascertaining the rights and obligations of participants in an express trust is the trust instrument. That is evident in the cases involving superannuation and pension funds also. As Nobles notes,[45] small differences in the drafting of key provisions in cases such as *Re Courage Group's Pension Schemes*,[46] *Imperial Group Pension* v *Imperial Tobacco*,[47] *Mettoy Pension Trustees v Evans*[48] and *Lock v Westpac* [49] had a material impact on the way the courts balanced the competing claims to the funds' surpluses. A similar attention to the precise wording of key provisions can be seen in more recent cases involving insurance claims by members, such as *Telstra Superannuation v Flegeltaub*,[50] *Hay v Total Risk Management,* [51] and *Finch v Telstra*.[52]

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42 *CARE v Bishop* (Unreported, Federal Court of Australia, Northrop J, 31 July 1997); Noel Davis, *Law of Superannuation in Australia,* NexisLexis online, [27,010].

43 National Superannuation Committee of Inquiry, Parliament of Australia, *National Superannuation in Australia* (1974), 26.

44 *Costa v Duppe Properties Pty Ltd* [1986] VR 90, 93 (Brooking J). See also Joseph Campbell, 'Access by trust beneficiaries to trustees' documents information and reasons' (2009) 3 *Journal of Equity* 97, 142.

45 Nobles, above n 15, Ch2.

46 *Re Courage Group's Pension Schemes; Ryan et al v Imperial Brewing and Leisure* [1987] All ER 528.

47 [1991] 2 All ER 597.

48 [1991] 2 All ER 513.

49 (1991) 25 NSWLR 593.

50 [2000] 2 VR 276, 282 (Callaway J).

The location of all key rights, expectations and obligations in a single document[53] makes it easier for participants in a trust to know unambiguously the nature of those rights, expectations and obligations. [54] The fact that these terms of the trust are specified at a local, fund by fund, level is also attractive from a systemic perspective. It permits participants in the system to create institutions optimally suited to meeting their local (negotiated) needs and circumstances, a potential that, if met, would promote achievement of the economic efficiency objective identified in Chapter 2.[55] However, as we shall see, the reliance on the trust instrument to define the rights, expectations and obligations of participants in a superannuation fund also has shortcomings from a regulatory perspective that cannot be ignored.

The risks posed by trust law's subordination to the trust instrument

Policy makers and regulators have often expressed concern about the risk of a regulatory dialectic in which the subjects of regulation respond to regulatory initiatives in ways intended to bypass or undermine the regulation.[56] The autonomy granted to those drafting trust instruments to specify the terms of the trust facilitates just such a dialectic. In theory at least, opportunistic drafters could circumscribe members' rights and/or limit the obligations borne by the trustee and thereby compromise regulatory objectives to a very

51 [2004] NSWSC 94.

52 [2010] HCA 36.

53 The trust instrument may from a practical perspective be comprised of more than one physical document, as where for instance amendments have yet to be consolidated. The document is often, but not always, a deed. Davis, above n 42, [5,050].

54 This clarity does of course to some extent depend on the clarity with which the instrument has been drafted. Some older trust deeds can be opaque indeed.

55 This is discussed further in Chapter 8.

56 See for instance Julia Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) 3(4) *Capital Markets Law Journal* 425, 431; Phillip Cerny, 'Power, markets and accountability,' in Andrew Baker, David Hudson and Richard Woodward (eds), *Governing financial globalisation; international political economy* (Routledge, 2005), 37; Edward Kane, 'The Dialectical Role of Information and Disinformation in Regulation-Induced Banking Crises' (2000) 8 *Pacific Basin Finance Journal* 285.

great extent. It is a process described by Getzler as 'cautelary jurisprudence' [57] and is arguably as old as trust law itself.[58]

The possibility that trust law may not by itself be able to secure the interests of members is a major issue for a regulatory scheme so reliant on trust law for its legal infrastructure. In the paradigm trust, where the beneficiaries are volunteers, there may be sound policy reasons for privileging the intentions of the settlor in this way. However these are not as compelling in the superannuation context. For a start, the members of a superannuation fund are not volunteers.[59] Moreover, and perhaps more pertinently, the party responsible for drafting the trust instrument is typically an entity with commercial or other motivations of its own, such as a financial institution, employer or industry body. To the extent that the interests of that entity may not be precisely aligned with those of the members, the autonomy implicitly granted to such entities is a threat to the regulatory objectives described in Chapter 2.

There are several other consequences that should also be considered. The autonomy given to the party responsible for drafting the trust instrument means that the rights of members may differ quite markedly between funds. Those differences might include members' access to information or the ability to hold trustees liable to account for certain types of defaults. At the very least this variation will contribute to the fragmentation of experience across cohorts of members that was discussed in Chapter 2.

At a more general level, it also means that generalisations about the protections afforded to members have to be expressed in more qualified terms. It is dangerous to talk of all members across the superannuation system having certain rights, unless those rights have been secured by way of legislative or regulatory instrument. This in turn means that regulatory initiatives seeking to provide greater (or different) protection have to be sensitive to the disparity that may exist between different funds. A regulatory rule that may work in

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57 Joshua Getzler, 'Legislative incursions into modern trusts doctrine in England: The Trustee Act 2002 and the Contracts (Rights of Third Parties) Act 1999' (2002) 2 *Global Jurist Topics,* 1.

58 See for instance Moffatt, above n 18, 1, 33 – 45.

59 *Finch* above n 52, [33].

respect of one fund with its trust instrument drafted in one way may be ineffective or even dysfunctional in respect of another where the drafting is different.

Finally, the variability in instruments complicates any adjudicative process, as it makes close attention to the fine details of the context necessary for each decision. This inevitably raises the costs of curial proceedings, which in turn may serve as a disincentive for aggrieved parties to seek redress.

The potential for self-protection

There are some, including contractarians, who might argue that the terms of the trust instrument reflect the resolution of a negotiation between self-interested parties.[60] Specifically in the superannuation context, Stone, for instance, suggests that:

> The provisions of superannuation trust deeds are generally the result of negotiated agreement between the interested parties within a statutory framework.[61]

With respect, that seems naïve. There are few if any grounds for confidence that employees *qua* members are in a position to act individually or collectively to secure terms that protect their interests in a superannuation context. For a start, it is highly unlikely that many members would have been present when the original terms of the trust instrument were 'negotiated'. The passage of time, if nothing else, would ensure that. Equally, recent experience suggests that members may even have little ability to influence directly amendments to the trust instrument that affect their interests.[62] The result, as Paatsch and Smith noted in 1992 (a time when corporate funds were relatively more important that they are now) is that:

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60 John Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *Yale Law Journal* 625.

61 Margaret Stone, 'The superannuation trustee: Are fiduciary obligations and standards appropriate?'(2007) 1 *Journal of Equity* 167, 174.

62 See for instance Stephen Long, 'Key fund's woes put super at risk for thousands' *Australian Broadcasting Corporation News*, 13 Dec 2011.

> The undue influence of employers, in the design process, has often created inequitable and unsuitable fund deeds from the point of view of beneficiaries.[63]

Alternatively, it is also possible to argue that the advent of Fund Choice means that members have the ability to protect themselves from the risk of self-interested drafting by choosing to have their contributions paid into a different fund or even into a self-managed (SMSF) fund.[64] The problem with that argument, as the Cooper Review found, is that members are too disengaged, superannuation is too technical and complex, and the avenues for collective action are too emaciated,[65] to generate anything approaching a dynamic of consumer sovereignty in the superannuation system.[66]

The idea therefore that the terms of a superannuation trust instrument represent a negotiated outcome in practice is untenable, and with that conclusion comes the possibility that some form of regulatory intervention may be required to redress the imbalance.

The most obvious way for that to happen is through direct government intervention, particularly statute. This is precisely what we see in the regulatory scheme governing superannuation. Parliament has intervened via statute to secure those requirements it regards as essential to the achievement of the system's objectives. However, as we shall see briefly below (and in much more detail in Chapter 5), it has done so in a limited, targeted way. As such, the intervention respects and thereby reinforces the central role of the trust instrument in the governance of superannuation funds at a local, fund-by-fund level.

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63 Dean Paatsch and Graham Smith, 'The Regulation of Australian Superannuation: An Industrial Relations Law Perspective. Part 2' (1992) 6 *Corporate and Business Law Journal* 29, 30.

64 Indeed it is clear that the migration of many of the more affluent members into the Self Managed Super Fund sector is a symptom of a desire for greater control over their superannuation; Australian Stock Exchange, 'Self-Managed Superannuation Fund (SMSF) Market Research (Qualitative Project)' *Media Release* (November 2003).

65 See for instance the conclusion derived by the Review that Annual General Meetings of members were unlikely to be effective; Cooper Review, *Final Report: Part Two*, 58.

66 Cooper Review, *Final Report: Part One*, 7 - 8.

The response of the regulatory scheme to the problem

There is no doubt that the vulnerability of the trust instrument influenced the drafting of the *SIS Act*. As Hon. John Dawkins MP noted when introducing the *SIS* legislation:

> Trust law imposes a substantial discipline on trustees, but it has some deficiencies in practice …in recognition of these deficiencies, the Government will introduce legislation to impose specific obligations on [trustees and their directors] … These essential trustee duties … will not be able to excluded or modified by governing documents. [67]

The *SIS Act* was thus expressly intended to buttress trust law. It is perhaps surprising, then, that there is relatively little regulation dictating the content of the trust instrument and rules in the superannuation context. Indeed Dawkins went on to note that:

> In view of the wide diversity of superannuation funds, it is important that there be flexibility in the drafting of deeds to suit the circumstances of individual funds[68]

As a result, those drafting trust instruments enjoy relatively few constraints, other than those required to maintain the fund's status as a 'complying fund' under the *ITAA* and the handful of provisions in Part 6 of the *SIS Act*.

Part 6 of the *SIS Act* is titled 'Provisions relating to governing rules of superannuation entities'. It contains a collection of provisions designed to limit the flexibility of settlors and those who would amend the terms of the trust. But the list is surprisingly short.

The trustee covenants

Most notable in Part 6 of the *SIS Act* are the s 52(2) covenants. These covenants were intended to articulate the 'essential' or 'fundamental' obligations of trustees in a way that was non-excludable and irrevocable.[69] Some are directed towards buttressing the 'adverbial'[70] duties enforced by equity on trustees. As is described in more detail in Chapter

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67 Dawkins, *Strengthening Super Security* (1992), 6.

68 Ibid, 9.

69 Ibid, 6. Ironically, the true' fiduciary' duties, the conflicts and no-profits rules, were not (and are still not) included in the list.

70 This description is employed to denote specifically those duties on trustees that relate to the quality of their conduct: careful, honest, unconflicted, and so on. In some ways it resembles Conaglen's notion of non-fiduciary duties, except that here the core duty is the duty to give

5, they effectively require trustees to act honestly,[71] with care, skill and diligence[72] and in the best interests of beneficiaries,[73] and to avoid fettering the exercise of their discretion.[74] There are also administrative duties entrenched by the s 52(2) covenants, namely to keep trust monies separate,[75] to invest in accordance with a pre-set investment strategy,[76] to manage any prudential reserves held by the fund[77] and to provide information to beneficiaries.[78]

It is telling that these obligations are imposed in the way they are. The legislature could have chosen to impose the key obligations directly (as was done for equivalent provisions in the UK *Trust Act 2000* and in the various *State Trustee Acts,* as well as Chapter 2D of the *Corporations Act*).[79] Instead the rules imposed by these provisions operate indirectly. They modify the trust instrument, rather than imposing duties or prohibitions directly on the trustee. As there is no reason to suppose that these statutory rules could not have been imposed directly on trustees, it seems reasonable to suppose that the choice of statutory technique was not trivial. It must be interpreted to signal a desire to respect the centrality of the trust deed in the functioning of the trust.

Exculpatory clauses

Part 6 of the *SIS Act* also addresses the concern that trust instruments might be drafted to contain overly-wide exculpatory clauses. Section 56(2) voids any provision of a trust deed

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effect to the trust (with all the administrative duties that entails) rather than the duty of loyalty; Matthew Conaglen, *Fiduciary Duty. Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010).

71 *SIS Act*, s 52(2)(a).

72 *SIS Act*, s 52(2)(b).

73 *SIS Act*, s 52(2)(c).

74 *SIS Act*, s 52(2)(e).

75 *SIS Act*, s 52(2)(d).

76 *SIS Act*, s 52(2)(f).

77 *SIS Act*, s 52(2)(g).

78 *SIS Act*, s 52(2)(h).

79 *SIS Act*, s 62, the 'sole purpose test' is the main exception to this positioning. It is discussed in detail in Chapter 5.

that 'would have the effect of exempting a trustee of the entity from, or indemnifying a trustee of the entity against:

> (a) liability for breach of trust if the trustee:
>
> > (i) fails to act honestly in a matter concerning the entity; or
> >
> > (ii) intentionally or recklessly fails to exercise, in relation to a matter affecting the entity, the degree of care and diligence that the trustee was required to exercise; or
>
> (b) liability for a monetary penalty under a civil penalty order'

This addresses a concern, described by Dal Pont[80] that 'exclusion of liability' clauses could effectively curtail or even eclipse entirely the protective effect of the adverbial duties owed by trustees at general law.

Section 56(2) seems sensible on its face. But is it? Why is it only breaches of the duty to act honestly (s 52(2)(a)) and the duty to act carefully and diligently (s 52(2)(b)) that are entrenched in this way? Specifically why is there no reference to other trustee obligations, such as the requirement to act in members' best interests (s 52(2)(c)), not to fetter their exercise of discretion (s 52(2)(e)) or to provide prescribed information upon request (s 52(2)(h))? Nor is reference made to general law duties which, as was noted above, are presumed to subsist as a result of s 350. Is it really intended that clauses purporting to exempt trustees from liability arising from breach of those other covenants, or general law duties such as impartiality, should be treated differently? If the drafting of the key provisions of the *SIS Act* was otherwise unexceptionable (and the analysis in Chapter 5 suggests a range of other flaws)[81] it might be possible to presume that the implicit differentiation was deliberate. However there does not appear to be any compelling policy reason for the differentiation and, given that Parliament saw fit to include the obligations in the list of covenants, it is indeed anomalous that the same legislation should implicitly permit them to be undermined in this way. It therefore seems likely that statutory

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80 Gino dal Pont, 'The Exclusion of Liability for Trustee Fraud' (1998) 6 *Australian Property Law Journal* 1.

81 Lindgren, in his analysis of s 56(1) and (2) identifies a number of other drafting anomalies that defy confident explanation. None bear on the issue under investigation here, but they do underscore the broader point about the infelicity of expression present in the *SIS Act*; Hon Kevin Lindgren, 'A superannuation fund trustee's right of indemnity' (2010) 4 *Journal of Equity* 85.

intervention may be required if the overarching regulatory objective of ensuring that the ‘essential trustee duties’ identified by Dawkins cannot be ‘excluded or modified by governing documents’.

Concluding Comments

Trust law’s deference to the trust instrument exposes the regulatory scheme shaping superannuation to the risk of opportunistic drafting designed to limit members’ rights and trustee liability. The *SIS Act* responds to this in a variety of ways. In some cases it acts directly, as in s 62 (the sole purpose test). However, in others, it buttresses key adverbial trustee duties by implying covenants into the governing rules of each superannuation fund. In other cases it voids provisions of any trust instrument inconsistent with the overarching regulatory objective to protect members. Crucially in both these latter cases, the *SIS Act* preserves the privileged position of the trust instrument. It chooses to act, in these respects at least, through the trust instrument.

4.3 The role of the trustee

The second aspect of the trust model that deserves further attention is the way that trust law provides a governance infrastructure for the institution. Specifically, trust law focuses responsibility on the trustee for the administration of the trust.[82] This is important from a regulatory perspective because it isolates and identifies the trustee as the most logical subject for regulation.[83] It also facilitates the process of remediation of any deficiencies in the administration of the trust.[84]

The trustee as the 'responsible entity'

Today it is largely taken for granted that the administration of a superannuation fund is the responsibility of the trustee, albeit with the remunerated assistance of contracted agents such as investment managers, custodians and member-benefit administrators. However this was not always the case, at least not for superannuation funds that were offered to the public. Prior to 1993, legal responsibility for the management of public offer superannuation funds was formally split between two distinct and independent entities: a fund manager and a trustee.[85] One of the key (and today largely forgotten) innovations of the *SIS Act* was to abolish this bifurcation of responsibility for public offer superannuation funds in favour of the single-entity structure that is more consistent with the standard trust model. The *SIS Act* for the first time located all responsibility for 'operating' the superannuation fund in a single entity, the 'responsible entity',[86] irrespective of whether the

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82 The term 'administration' here is used in its trust law sense to include both management of and disposition of the assets of the trust and not the more bureaucratic connotation it carries in lay discourse.

83 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1.

84 Dawkins, *Strengthening Super Security* (1992), 6.

85 Noted in Senate Select Committee on Superannuation, Parliament of Australia, *Super Supervision Bills* (1993), [5.4].

86 Law Reform Commission, *Superannuation* (1992), 8.2.

fund was open for public subscription or not. This 'responsible entity' was then to be, and still is, the primary subject of the regulatory scheme established by the *SIS Act*.[87]

Importantly, it was the trustee characterisation of that role that prevailed. In the superannuation context the responsible entity assumed the characterisation of 'trustee' rather that 'fund-manager'.[88] That occurred even although it was most often the fund-manager that had played the dominant role in the 'dual-entity' structure that comprised the institution prior to 1993 and it was the entity that had played the role of fund-manager up to that point and assumed the responsibilities of the trustee, rather than the other way around.

One reason why the trustee characterisation prevailed is the language of the *SIS Act*. Chapter 5 describes how the *SIS Act* deliberately makes use of trust law terminology in respect of key concepts and rules.[89] More directly, though, the covenants imposed in s 52 of the *SIS Act* were specifically designed to ensure that certain elements intrinsic to trusteeship are contained in the governing rules of the superannuation fund.[90] This in effect ensures that, whichever of the entities became the responsible entity as a result of the changes in 1993, its responsibilities were inalienably imbued with the unique character of trusteeship. The *SIS Act* thus ensured, and continues to ensure, that the responsible entity is not a trustee in name only; there is substance to the characterisation.

This approach was possible because of the way that trust law places the trustee at the fulcrum of the institution. The trustee is typically empowered to make all key decisions, to exercise the key discretions and to act with respect to the assets held on trust. As was noted in Chapter 3, the trustee is thus uniquely responsible, in the sense termed 'role-

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87 To underscore the significance of this change, it is striking that the single entity structure was not adopted for unit trusts outside the superannuation context until the *Managed Investments Act* 1998 (Cth).

88 By way of contrast, in the managed investments context the entity is still commonly referred to as the fund manager. The events and debates that led to the adoption of the single entity model in the managed investment context are colourfully described in Bernard Mees, Monica Wehner and Pamela Hanrahan, 'Fifty Years of Managed Funds in Australia' (Preliminary Research Report, IFSA, 2005).

89 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1.

90 Dawkins, *Strengthening Super Security* (1992), 6. This is described in detail in Chapter 5.

responsible' by Hart.[91] By relying on the trust as the legal infrastructure for the system, the regulatory scheme established by the *SIS Act* could harness that modality.

The regulatory consequences of focused accountability

It was also noted in Chapter 3 that the trustee is 'responsible' in the sense of being accountable to beneficiaries for certain proven deficiencies in the administration of the trust. This is the 'legal-liability-responsibility' described by Hart.[92] Beneficiaries seeking redress for a perceived deficiency in the administration of the trust can focus their attempts for redress on the trustee. This is true whether redress is sought through the courts,[93] or in the superannuation context through some mechanism afforded them by the regulatory scheme[94] or a process internal to the superannuation fund.[95] Indeed the principle in general trust law that trustees are jointly and severally liable for breaches of trust[96] means that beneficiaries need not even identify the trustee causally responsible (in a lay sense) for the breach when seeking remediation; it will be up to the trustees to adjust the liability to account *inter se*.[97] That of course is not an issue in the superannuation context where there is almost always[98] a single incorporated entity serving as trustee. Nevertheless, it is symptomatic of a desire on the part of the courts to ensure that the beneficiaries' right to

91 H L A Hart, *Punishment and Responsibility: Essays in the Philosophy of Law*, (OUP, 1968), 212.

92 Ibid, 215.

93 For instance pursuant to s 92 of the *Trustee Act 1925* (NSW), or the equivalent provisions in other States and Territories.

94 For instance pursuant to s 56(3) of the *SIS Act*.

95 Section 101 of the *SIS Act* requires trustees to establish a complaints and enquiries procedure such that members can expect to receive an answer to an enquiry or complaint relating the operation or management of the fund within 90 days.

96 *Bahin v Hughes* (1886) 31 Ch D 390.

97 Trustees innocent of a breach do have rights of contribution from co-trustees but the beneficiary can turn to any of its trustees for remediation. It is up to the trustees to arrange amongst themselves (possibly with the assistance of the court) where the financial burden of meeting that remedy should ultimately lie; *Lingard v Bromley* (1812) 1 V&B 114; 35 ER 45.

98 Cooper Review, *Final Report: Part Two*, 44. For the reasons described below, almost all superannuation funds today have an incorporated entity serving as trustee.

have the trust administered properly is not undermined by governance arrangements over which they have no control.[99]

The same focused location of accountability that facilitates remediation by members, assists policy-makers and regulators as well.[100] The modality of the trust provides a discrete, identifiable subject for regulation; the trustee. As was noted above, this is an opportunity that both policy-makers and regulators have exploited in the regulatory scheme applied to superannuation. The *SIS Act* focuses almost all of its attention on trustees, as does the regulatory scheme more generally. In addition to the rules that regulate the quality of trusteeship required, such as the s 52 covenants described in detail below, trustees now have to be licensed.[101] They also have responsibility to report to the regulator on a regular[102] and *ad hoc* basis.[103] In contrast, the regulatory scheme barely touches other entities commonly employed in the system, such as funds managers, custodians and administrators.[104] These agents of the trustee are responsible to the trustee, but the trustee is the primarily responsible for the administration of the trust as far as members and regulators are concerned.

The incorporated trustee

The trustees of most superannuation funds today are incorporated entities. This is because for constitutional reasons, s 19(3) of the *SIS Act* requires that superannuation funds must either have a corporate trustee or alternatively be constituted to pay pensions to members

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99 On the variety of ways in which the courts safeguard this right see David Hayton, 'The Irreducible Core Content of Trusteeship', in A J Oakley (ed), *Trends in Contemporary Trusts Law* (Clarendon, 1996)

100 Productivity Commission, *Review of the Superannuation Industry* (2001), 6.1.

101 See Chapter 1 above.

102 See for instance s 36 of the *SIS Act* (provision of audit report).

103 See for instance *SIS Act* ss 29HC (changes to risk management strategies), 29JA (breach of licence requirement), 29PC (changes to risk management plans) and s 106 (significant adverse events).

104 See Chapter 1 above.

upon their retirement to be eligible to be a regulated superannuation fund.[105] This latter alternative is unattractive to most funds as fund members typically elect to receive their superannuation payouts in lump sum, rather than pension, form.[106]

The interposition of a corporation as trustee is of far greater consequence than most have appreciated. On close inspection it has both positive and negative consequences for the regulatory scheme.

Positive aspects of a corporate trustee

There are a number of practical advantages that flow from the requirement for a corporate trustee.

First, the legal fiction of the corporation affords the trustee perpetual succession. This is extremely valuable in an institution with as long an expected lifespan as a superannuation fund. Changes in the directors of the trustee company are inevitable over that timeframe given human mortality and the representative nature of many board appointments.[107] Indeed key industry associations actively advocate the adoption of governance practices, such as succession planning and board rotation, that are designed to ensure a smooth and continuous process of board replenishment.[108] The result is that the average tenure for directors of superannuation funds currently stands at approximately 6.5 years for industry and public sector boards and 4 years for corporate and retail fund boards.[109] The fact that this turnover in human actors can be accommodated within the institution means that the legal title in the assets of the fund is not disturbed by the inevitable changes in human actors.

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105 The approach required to give the Commonwealth constitutional power to legislate with respect to the superannuation system was described in Chapter 1.

106 Cooper Review*, Final Report: Part Two*, 44.

107 APRA notes that the average number of years directors have served on their current board is 5.3 years, with 64 per cent having served five years or less. Only 20 per cent of directors are specifically member appointed, with the remainder mostly appointed by employers (32 per cent), unions (14 per cent) or the financial institution offering the fund (up to 26 per cent). APRA, 'Superannuation fund governance: Trustee policies and practices' (2008) *Insight*, 6.

108 See for instance Australian Institute of Superannuation Trustees, *A Fund Governance Framework for Not-for-Profit Superannuation Funds* (March 2011).

109 APRA, above n 107, 13.

The use of a corporate trustee gives rise to other administrative efficiencies also. It means the legal ownership of all assets is held by a single owner, rather than jointly by individual trustees. It also means that there is a single point for contracting parties dealing with the fund.

The use of a corporate trustee also facilitates regulation in some quite practical ways. The way that trust law's location of responsibility in the office of trustee facilitates regulation was noted above. The presence of multiple trustees would undermine that virtue. Housing that multiplicity of human actors within the corporate form solves that problem (albeit with the drawbacks discussed in detail below). Requiring incorporation also enables the regulatory scheme to harness the administrative machinery associated with the registration[110] and ongoing reporting[111] required of companies under the *Corporations Act*. It also makes the imposition of licensing and capital adequacy requirements simpler to effect. Indeed it is hard to see how either licensing or the capital adequacy regime could be applied in practice if there were multiple trustees of a superannuation fund.

Issues associated with the interposition of an incorporated trustee

The trust model relies on an axis of accountability running from the trustee, who is 'role responsible', to the beneficiary(ies).[112] The interposition of an incorporated entity as trustee undermines this in two respects. First it means that the key decision makers with respect to the trust no longer owe duties directly to the beneficiaries. This has a material impact on the application of the fiduciary proscription on conflicts, in particular. Second, it dilutes the quality of accountability across the superannuation fund. These two sets of issues are discussed below.

The problems arising from the double articulation in the axis of accountability

The interposition of the corporation as trustee means that the human actors responsible for making decisions on behalf of the superannuation fund are not trustees *per se* but rather directors of a corporation that is acting as trustee.

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110 *Corporations Act,* Chapter 2A.

111 *Corporations Act,* Chapter 2M.

112 *Morlea Professional Services Pty v Richard Walter Pty Ltd (in liq)* (1999) 96 FCR 217, [33].

This is important in the first instance because the directors of a corporation owe their duties to the corporation and not, at least directly, to other possible stakeholders.[113] That is true even where the corporation is a trustee,[114] and whether the duties arise at general law or from operation of statute,[115] unless the relevant statute provides otherwise.

This means that the individual human actors acting as directors owe fiduciary and other duties primarily to the corporation as directors and that, separately, the corporation owes fiduciary and other duties to beneficiaries as trustee.[116] There is thus a double articulation in duties: the directors owing duties to the corporation, which in turn owes duties to beneficiaries.[117]

At general law, then, the directors of a corporation acting as trustee of a superannuation fund do not ordinarily owe duties directly to members of the fund.[118] In legal terms the axis

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113 *Percival v Wright* [1902] 2 Ch 421. As Heenan J clarifies in *Geneva Finance Ltd v Resource and Industry Ltd* (2002) 20 ACLC 1427, even in the event of imminent insolvency, the interests of creditors are only relevant in so far as the interests of the company come to be identified with those of the creditors, the interests of equity-holders having been rendered worthless by the putative insolvency. An exception is created by s 187 of the *Corporations Act*, which permits directors of wholly-owned subsidiaries to have regard for the interests of the holding company in certain circumstances.

114 *Young v Murphy* [1996] 1 VR 279, 301 (Phillips J). Surprisingly, there is quite recent authority to suggest that directors of a trustee company may owe a fiduciary duty to the beneficiaries of the trust as well as to the company: *Hurley v BGH Nominees Pty Ltd (No2)* (1984) SASR 499, 510; *Inge v Inge* (1990) 3 ACSR 63, 69-70. Thankfully however, that approach now seems to have been overtaken by the more conceptually orthodox approach that the directors do not owe duties directly to beneficiaries unless there are special facts that would give rise to a fiduciary relationship: *ASC v AS Nominees Ltd* (1995) 133 ALR 1, 18; *Cope v Butcher* (1996) 20 ACSR 37; *Collie v Merlaw Nominees* [1998] VSC 203. Also see Barrett's criticism of *Hurley* in the case note at (1985) 59 *Australian Law Journal* 46.

115 *Collie*, above n 114, [95] (Byrne J).

116 This is not to deny that the corporation may also in certain circumstances owe duties to beneficiaries under contract; see Michael Vrisakis, 'Co-habitation of contract and trust relationships in contemporary investment trusts' (2008) 2 *Journal of Equity* 274.

117 This double-articulation is of course not unique to the superannuation context; it affects all corporate trustees.

118 That is not to discount the possibility that the court may find that the directors owe a fiduciary duty directly to members arising from the special facts of a case; see for instance

of accountability between trustee and beneficiary remains in place, but from a practical perspective the interposition of the corporate form breaks the axis of accountability traditionally believed to be an essential element of a trust;[119] that between the individual or individuals acting as trustee(s) and the beneficiaries.

Two main consequences flow from this. First, if the directors do not owe a duty to members, then there is nothing against which the interests (or other duties) of the directors can conflict. The second is that it would appear to deprive members standing to enforce appropriate behaviour on the part of those individuals whose decisions directly affect their interests. Each deserves further attention.

i Conflicts of interest

Trustees owe a duty of loyalty to beneficiaries.[120] That is to say, they must avoid any conflict between the duty owed to the beneficiaries under the trust and any interests they may have or duties they may owe to others. When combined with its close relative, the rule prohibiting the retention of unauthorised profits from the office of trustee,[121] the duty of loyalty can be said to constitute the fiduciary heart of trust law.[122]

A number of commentators have discussed the peculiar incidence and character of conflicts of interest and duty that arise in the context of superannuation and pension funds.[123] They note for instance the need, as seen in *Drexel Burnham*,[124] for trust law to accommodate the

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the duty owed by directors to shareholders in *Brunninghausen v Glavanics*(1999) 32 ACSR 294.

119 Hayton, above n 99.

120 *Molyneux v Fletcher* [1898] 1 QB 648.

121 *Keech v Sandford* (1726) 2 Eq Cas Abr 741; 25 ER 223.

122 See for instance Conaglen, above n 70.

123 See for instance Sir Robert Walker, 'Some Trust Principles in the Pensions Context' in A J Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon, 1996); Marina Milner, 'Pension Trusts: A New Trust Form?' (1997) 61 *Conveyancer* 89; N. Moore, 'Trustees' duties in relation to money purchase schemes' (1999) 13 *Trust Law International* 2; Sir Anthony Mason, 'Superannuation and Conflicts of Interest', (Paper presented at Law Council of Australia Superannuation Conference 2005); M. Fitzsimmons, 'Managing Pension Scheme Trustee Conflicts of Interest' (2006) 20 *Trust Law International* 211.

124 *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32.

inevitability of individuals facing conflicts between their interests as members and their duty as trustees (a conflict of interest and duty).[125] They also identify the fact that the individuals serving on trustee boards often do so in a 'representative' capacity which, on its face would seem to encroach upon their duty to act in the interests of the membership as a whole (a conflict of duty and duty).[126]

One problem they typically do not identify however is that when a corporation is interposed as trustee, it severs the axis of accountability between the (now) director and the members of the fund.[127] There can be no 'conflict' if the individual owes no duty to the member. If directors of a trustee owe no duty directly to members, they cannot be expected to avoid conflicts before they arise nor to prioritise members' interests if they do arise. Directors are required by the *Corporations Act* to exercise their powers and discharge their duties in good faith in the best interests of the corporation[128] and, should it happen that the interests of the company and its duty as a trustee diverge, logic suggests that the directors are expected to prioritise the interests of the company.[129] Most often, of course, it will be in the interests of the company to respect and meet its obligations to third parties, be they contractual, tortious or equitable. However in the event of a conflict, it seems clear from a corporate law perspective that the company's interests must prevail.

Such competition between interests may be undesirable from a trust law perspective but it is not so obvious that the near-absolute priority attached to members' interests is desirable

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125 Walker, above n 123, 132; Mason above n 123.

126 Mason, above n 123; Milner, above n 123.

127 One exception is Mason, above n 123. Another problem that garners little attention in the academic literature is that the potential for conflict can be bypassed altogether by careful drafting of the trust deed to embed what would otherwise be a conflicted situation (for example the appointment of a related party to serve as an agent of the trust) into the terms of the trust. Since this latter problem is merely an example of the vulnerability of trust law to self-serving drafting that was discussed above, no further discussion is required at this point. This problem of 'embedded' provisions was identified in the Cooper Review and specific recommendations were designed to address it: Cooper Review, *Final Report: Part Two*, 60.

128 *Corporations Act*, s 181.

129 See Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, 2010), [8.110].

in the superannuation context. Whilst it is true that many corporate trustees in the superannuation system operate on a not-for-profit basis, many are commercial entities with a legitimate expectation of earning a commercial rate of return on their capital. To overbear their interests entirely in favour of members may be going too far. As Chapter 2 described and Chapter 8 develops more fully, the involvement of commercial entities was deemed important in 1993 to promote efficiency and innovation both at a local and at a systemic level. There is no reason to suppose that that should change. Thus what is required is a balancing of the interests of beneficiaries against those commercial interests rather than a domination (in either direction) of one over the other. Chapter 9 makes some recommendations in this regard.

Finally, it is true that those corporate trustees subject to the AFSL regime are required to formulate and implement a conflicts policy.[130] That policy will almost inevitably privilege 'customer' interests over those of the corporation's other stakeholders, and might therefore be thought to create something approaching a duty on which those members could rely.[131] In practice, though, this duty is undermined by the fact that (absent some provision in the offer documents) members would not have standing to enforce the rules constituting the policy. Indeed the only external constraint on the corporation is the threat of regulatory action, such as revocation of the AFS licence, a potentially heavy-handed but certainly imprecise and un-nuanced means of effecting compliance. As a result, conflicts between the interests of members and those of directors remain a pervasive problem today.[132]

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[130] *Corporations Act,* s 912A(1)(aa).

[131] For a detailed discussion of the many fine points of distinction between the equitable duty and the statutory regime, see Vince Battaglia 'Dealing with conflicts: The equitable and statutory obligations of financial services licensees' (2008) 26 *Company and Securities Law Journal* 483.

[132] Cooper Review, *Final Report: Part Two*, 59; Hedley Thomas, 'Union super fund hit by conflicts, failures' *The Australian*, 25 June 2012; Sally Patten, 'APRA puts pressure on union funds' *Australian Financial Review*, 18 June 2012, 1.

Ii Standing

It may seem trite to observe that individual beneficiaries have standing at general law to sue for a breach of trust.[133] However that right exists against the trustee, not against the directors of a company acting as trustee. *Prima facie*, then, individual members would have no right of action directly against directors of an incorporated trustee for breaches by the trustee resulting from decisions of those directors.

In practice, of course, this may matter little to an aggrieved member. Breaches by the directors of an incorporated trustee of a sort affecting the member's interests are likely to result in a similar breach by the trustee corporation. So, for instance, a failure by an individual director to exercise care in the execution of a duty will most likely also represent a failure by the trustee company to exercise the requisite care. The aggrieved beneficiary can therefore take action against the trustee and need not worry about the contribution made to the alleged default by the underlying human actors. It may also be the case that, pragmatically, the individual member has an incentive to direct their litigation towards the trustee, as the easier and potentially better-capitalised target.[134]

There is a broader problem. The axis of accountability between trustee and member is a key element of the trust. It has attractive remedial qualities, but perhaps just as important, precisely targeted individual accountability is also a powerful deterrent against self-serving or otherwise deficient behaviour. The threat of beneficiaries taking action personally against the trustee is a key element of the accountability matrix ordinarily part of a trust. The inability of a beneficiary to mount an action against the individuals responsible for the decisions taken in relation to the trust is therefore a significant deviation from the substantive content of the standard trust model.

It is of course debatable whether individual accountability is as appropriate in the context of a large financial enterprise such as a modern superannuation fund as it may be in a more

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133 J D Heydon and M J Leeming, *Jacobs Law of Trusts* (LexisNexis Butterworths, 7th ed, 2006), [2303].

134 Note the presence of directors' indemnities and insurance muddies the waters in respect of whether the trustee company or the individual director would have 'deeper pockets' so this element of the calculation of who to sue is arguably less decisive than is sometimes the case.

familial or testamentary context. Tellingly, however, the *SIS Act* itself was partly justified as an attempt by Parliament to address the situation where:

> it may be possible for the directors of the company to escape liability for actions committed by the trustee.[135]

So the intention of the legislature, at least, would seem to be clear: the corporate veil was not intended to shield individual directors from the accountability to members that they would face if they were trustees in their own right.

The dilution of accountability

The interposition of the corporation as trustee not only complicates the matrix of accountability in the superannuation fund; it also dilutes the accountability of key decision-makers in the institution.

There are three ways in which the accountability present in the trust model is diluted in the superannuation context by the requirement that funds have a corporate trustee. One is the ambiguity caused by overlap in the *Corporations* and *SIS Acts.* Second, there are also fundamental differences in the nature of collective-decision making in the corporate and trust contexts. Finally, there are issues that arise from the incongruity of personifying a legal fiction. These are discussed in detail below.

i Ambiguity in the content of duties

The *Corporations Act* imposes a range of requirements on the directors of corporations. It is uncontroversial that these apply to the directors of corporations acting as trustees of superannuation funds. It is also uncontroversial that the context of the decision-making will inform the content of those duties.[136] As Finn J found in *ASC v AS Nominees:*

> Where the trustee is itself a company the requirements of care and caution are in no way diminished. And here, unlike with companies in general, *these requirements have a flow on effect into the duties and liabilities of the directors of such a company*. It was early established – largely it would seem from case law on charitable and municipal corporations – that at least when, and to the extent that, directors of a trustee company are themselves

135 Dawkins, *Strengthening Super Security* (1992), 6.

136 *Re City Equitable Fire Insurance Company, Ltd* [1925] 1 Ch 407.

> 'concerned in' the breaches of trust of their company, they are liable to the company according to the same standard of care as is expected of the company itself[137] (emphasis added)

There are however several problems with this approach in practice.

The first is easily dealt with. Justice Finn's comments above were in support of a statement of the NSW Court of Appeal held in *Daniels v AWA*:

> 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 capital investment[138]

Part 5.4 describes the duty of care owed by trustees of superannuation funds. It demonstrates that neither trust law nor the *SIS Act* in fact requires 'conservatism' in investment judgments. Both require that the trustee develop and implement an investment strategy appropriate for the circumstances of the trust, and in particular the needs of members.[139] However the fact that both the NSW Court of Appeal and Finn J invoked a spirit of conservatism that was probably inappropriate (and in the case of the NSW Court of Appeal, merely *obiter dicta*) does not derogate from the basic principle, now enshrined in s180 of the *Corporations Act*, that the standards of care, skill and diligence expected of directors are to be calibrated with reference to the circumstances of the company. The director of a corporate trustee of a superannuation fund will be expected to display the care and diligence appropriate to that context,[140] not some hypothetical entity with potentially quite different circumstances.

The second problem with Finn J's comment is more intractable. It arises from the fact that in some cases the standard of care imposed on the trustee may be lower than that ordinarily required of directors. Part 5.4 concludes that the regulatory scheme currently requires a standard of care (and possibly diligence) lower than that which would apply to

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137 *ASC v AS Nominees* (1995) 133 ALR 1, 13.

138 *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438, 494.

139 See for instance *Cowan v Scargill* [1985] 1 Ch 270; *Nestle v National Westminster Bank* [1993] 1 WLR 1260, and *SIS Act*, s 52(2)(c).

140 *ASIC v Rich* (2009) 75 ACSR 1, [7201]. On the position at general law, see Re *City Equitable*, above n 136.

directors today in corporate law. A set of rules which imposes higher standards on the individual than on the group comprising those same individuals seems incongruous, if not unworkable.

Might then the standard required of individual directors in the superannuation context actually be set at the lower standard required by the *SIS Act*? After all, the directors' duties are calibrated to the context, and the standard expected in the superannuation context would appear to be lower. This may seem paradoxical, but the possibility cannot be entirely dismissed. As Part 5.4 notes, the words employed in s 52(2)(b) of the *SIS Act* were chosen very carefully. It is conceivable, then, that the lower standard in s 52(2)(b) might inform the court's interpretation of what is required in applying s 180 of the *Corporations Act* to the superannuation context. That would have the effect of lowering the standard of care expected of directors of superannuation trustee companies below that expected of company directors generally. That, as Part 5-4 concludes, is surely a paradoxical (and some might consider undesirable) outcome.[141]

ii Diffusing accountability through collective responsibility

The second way in which the accountability present in the trust model is diluted in the superannuation context is that the interposition of a corporate form reduces the intensity of accountability felt by the individual for governance of the institution. Put simply, trust law is more focused on individual responsibility than corporate law.

Trust law imposes a strict accountability regime on individual trustees. It requires co-participation[142] and unanimity[143] in decision-making where there are multiple trustees unless there are contrary provisions in the trust instrument.[144]

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141 Oblique reference to this can be seen in the review's report: Cooper Review, *Final Report: Part Two*, 45 – 51.

142 *Cowell v Gatcombe* (1859) 27 Beav 568; 54 ER 225; *Re Flower and Metropolitan Board of Works* (1884) 27 Ch D 592.

143 *Dulhunty v Dulhunty* [2010] NSWSC 1465 (Slattery J); *Sky v Body & Anor* (1970) 92 WN (NSW) 934.

144 *Re Butlin's Settlement Trusts; Butin v Butlin* [1976] Ch 251. There are two main exceptions; where there is only one surviving trustee –*Trustee Act 1925* (NSW) s 57(1), or if the trust is for charitable or public purposes; *Re Whiteley; Bishop of London v Whiteley* [1910] 1 Ch 600.

By contrast, the accountability regime imposed on directors has a more democratic tenor. It is a basic rule of corporate law that individual directors ordinarily do not have authority to make decisions on behalf of a corporation – authority resides in the directors acting collectively as a Board.[145] The primary decision-maker in a corporation is therefore a unitary one; the Board. There will usually be provisions in the corporation's constitution that dictate how individual directors relate to this unitary decision-maker; what is required to pass a motion, whether directors can vote,[146] whether there is a casting vote in the event of a deadlock, what constitutes a quorum and so on. The result is that Board decision-making at a human level is at once collegial and collective.[147] It aims to take advantage of the multiplicity of complementary perspectives, skills, and information potentially available from a diverse group, as well as the error-limiting dynamics of group interactions extolled by the court in *Daniels v AWA*,[148] and by Bainbridge in the context of corporate boards generally.[149] As such it aims to ensure that a multiplicity of views are brought to bear on all key decisions, just as they are in the trust setting.

This is not to say that directors can hide within their collective responsibility. As Woolf LJ's noted in *Re Westmid*:

> the collegiate or collective responsibility of the board of directors of a company is of fundamental importance to corporate governance under English company law. That collegiate or collective responsibility must however be based on individual responsibility.

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145 *Re Westmid Packing Services Ltd; Secretary of State for Trade and Industry v Griffiths* [1998] 2 All ER 124.

146 Paradoxically the Cooper Review identified situations in which some directors on trustee boards did not even have a vote; Cooper Review, *Final Report, Part Two*, 56.

147 Austin and Ramsay, above n 129, [7.060].

148 *Daniels v AWA*, above n 138, 500.

149 Stephen Bainbridge, 'Why a Board? Group Decisionmaking in Corporate Governance' (2002) 55 *Vanderbilt Law Review* 1. For less optimistic assessments on the ability of group dynamics to improve corporate decision-making, see Marleen O'Connor, 'The Enron Board: The perils of groupthink' (2003) 71 *University of Cincinnati Law Review* 1233; James D Cox and Harry Munsinger, 'Bias in the Boardroom: Psychological foundations and legal implications of corporate cohesion' (1985) 48(3) *Law and Contemporary Problems* 83.

> Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them.[150]

There is a key difference, though. The requirement of unanimity in trust law means that an individual trustee, dissenting from his or her co-trustees, has an effective veto over the decisions made for the trust. Absent an express provision in a corporation's constitution, no director would enjoy such a capacity.

The presence of a *de facto* right of veto might be thought a double-edged sword.[151] On the one hand it provides what Slattery J in *Dulhunty v Dulhunty*[152] termed 'double control over the trust property,' safeguarding individual trustee dissent against overbearing majorities. On the other hand, such vetos can impede effective decision-making. As Street J noted in *Sky v Body*:

> If conflicting business considerations lead to such a divergence that the trustees are not able to act unanimously, then the simple position is that they cannot act[153]

Irrespective of whether the right of veto is regarded as a positive attribute of trust governance because it protects beneficiaries, or as a hindrance because it can cause trustee decision-making to stall, the importance of this difference should not be underestimated. It is another example where the protective architecture of trust law is undermined by the interposition of a corporate entity as trustee.

iii Anthropomorphism

There is a well known anthropomorphism embedded at the heart of corporations law; the corporation as a distinct and distinctive legal person.[154] The projection of human capabilities onto the legal fiction of a corporation has in the words of one commentator

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150 *Re Westmid*, above n 145, 130.

151 Anthony Ogus, 'The Trust as a Governance Structure' (1986) 36 *University of Toronto Law Journal* 186, 209.

152 Above n 143, [31].

153 Above n 143, 935.

154 The distinction is often traced to *Salomon v A Salomon & Co Ltd* [1897] AC 22, although as Meagher J in *Briggs v James Hardie* (1989) 16 NSWLR 549 noted (at 557) the distinction was well understood by the courts before then.

'mesmerised' courts, academics and policy makers.[155] It is relevant here because many of the rules applying to trustees were clearly formulated with a human actor in mind. What does it mean, for instance, to say that a trustee be 'honest' when the trustee is a corporation? Equally, what would it take to establish that a corporation faces a 'real and sensible possibility of conflict'?[156] The problem is that if the standards expected of a decision-maker are incongruous, then the accountabilities they attempt to impose will be, at best, weakened. This is particularly the case where the language used is intended to have normative effect, as is the case with the highly charged, emotive rhetoric of fiduciary law.[157]

The notion that the corporation is a separate legal identity from both its incorporators and its officers is staple fare for all students of corporate law.[158] That notion, though, has attracted the courts and some commentators to apply concepts to the corporation that might be more properly reserved for human actors. A colourful, but thankfully now superseded example of this is provided by Ford, whose authors note that the ancient law of uses (the precursor to the trust) did not permit a corporation to hold property on behalf of another because it had no 'soul', and as such could not be the 'repository of confidence',[159] which was the touchstone of equitable intervention. Another example drawn from the general law of corporations is the need to identify the corporate 'will' when attempting to fix a corporation with responsibility for a transgression, whether crime or tort, in which the state of mind of the alleged transgressor is relevant. In *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd,* a case in which the court was required to ascertain the 'intention' of a would-be purchaser of real property, Denning LJ famously observed:

> A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and

155 John Flynn, 'The Jurisprudence of Corporate Personhood: The Misuse of a Legal Concept', in Warren J Samuels and Arthur S Miller (eds), *Corporations and Society. Power and Responsibility* (Greenwood Press, 1987).

156 *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41.

157 The 'normative' role played by trust law in the superannuation context is specifically discussed in Chapter 7.

158 See for instance Austin and Ramsay, above n 129, [4.140].

159 Ibid, [4.225].

> agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such.[160]

Equally famous, and pertinent in the current context, is Lord Mansfield's comment that 'nothing in law is so apt to mislead than a metaphor.'[161] That caution, though not referred to directly, seems to have informed Hoffman LJ in his response to Denning LJ's metaphorical reasoning in *Meridian Global Funds Management v Securities Commission*.[162] In that case the court had to assess whether a particular course of action ought to be attributed to the corporation or was simply the work of two 'rogue' employees. Having outlined the appropriate rules of attribution, his Lordship commented on Denning LJ's metaphor:

> this anthropomorphism, *by the very power of the image*, distracts attention from the purpose for which Viscount Haldane L.C. said he was using the notion of directing mind and will[163] (emphasis added)

The point here is simple. It is dangerous to assume that rules crafted by the courts for application to human actors will apply with the same force, or have the same effect, when applied anthropomorphically to a corporation. There are for instance commentators who argue forcefully that honesty as a notion is inherently inappropriate for application to a corporation.[164] Though it is possible in the context under consideration here to bypass that particular example because the *SIS Act* ignores such reservations and in s 52(2)(a) expressly imposes an obligation to be honest, that does not dispose of the issue completely; two reservations remain.

The first is the possibility that imposing a requirement that is meaningless in the context of a corporation risks it being ignored. That is possible, but can be countered by noting that

160 [1957] 1 QB 159, 172.

161 Quoted in *Knox v. Gye* (1872) 5 L R E & I App 656, 676.

162 [1995] 2 AC 500.

163 Ibid, 509

164 For instance Martin Benjamin and Daniel Bronstein, 'Moral and Criminal Responsibility and Corporate Persons,' in Warren J Samuels and Arthur S Miller (eds), *Corporations and Society. Power and Responsibility* (Greenwood Press, 1987).

since a corporation acting as trustee of a superannuation fund must act honestly then one can argue, by implication, its directors and other officers must also act honestly, at least in so far as the affairs of the trust are concerned. Certainly it is hard to imagine dishonest behaviour on the part of a trustee corporation that did not originate in dishonest behaviour on the part of one of its officers. The legislative intent evident on the face of s 52(2)(a) encourages such an implication. Even so, this process of re-articulation robs the original rule of much of its motive force in much the same way as Hoffman LJ's reduction of Denning LJ's metaphor to a set of instrumental 'rules of attribution' undermined the vitality and impact of that formulation.[165]

There is another level to be considered briefly though. Some commentators argue that the interposition of a corporate entity interferes with the chain of moral responsibility between individuals on which much of the law relies.[166] This is a recurrent debate in the literature relating to corporate criminality[167] and, more recently, corporate social responsibility.[168] It goes to the very foundations of the common law and its resolution, if there is one, lies well beyond the scope of this Thesis. It suffices here to note that such a debate exists and finds instantiation in the issue of corporate trusteeship described here.

It would be a mistake to assume that the concern about anthropomorphism is limited to whether requiring a corporation to be 'honest' makes sense. It applies more generally. Indeed it applies to any rule that has as one of its elements the state of mind of the regulated party, whether that be *mens rea*, recklessness, intention or some other state. It

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165 A more complete discussion on the way these rules of attribution work, or don't work, in modern corporate contexts can be found in Brent Fisse and John Braithwaite, 'The Allocation of Responsibility for Corporate Crime: Individualism, Collectivism and Accountability' (1988) 11 *Sydney Law Review* 468.

166 See for instance Paul Arenella, 'Convicting the Morally Blameless: Reassessing the Relationship between Legal and Moral Accountability' (1992) 39 *UCLA Law Review* 1511.

167 See for instance Christopher Clarkson, 'Kicking Corporate Bodies and Damning Their Souls' (1996) 59 *Modern Law Review* 557.

168 For a recent discussion that bridges the gap between the two areas see Aurora Voiculescu, 'Changing paradigms of corporate criminal responsibility: lessons for corporate social responsibility,' in Doreen McBarnett, Aurora Voiculescu and Tom Campbell, *The New Corporate Accountability. Corporate Social Responsibility and the Law* (Cambridge University Press, 2007).

will also apply where the law relies even implicitly on the process of decision-making. It is one thing to imagine objectively the decision-process of a hypothetical human actor with assumed cognitive attributes, such as the 'reasonable person' or the 'prudent man', as a benchmark against which to make an assessment. It is quite another to do so for an institution comprising many actors, each playing a limited part in a complex, collective enterprise.

An example may make this more tangible. Take for instance the prophylactic conflicts rules so central to fiduciary doctrine, and hence trust law. Those rules don't specifically require the formation of a particular (compromised) state of mind on the part of the trustee,[169] but how would one ascertain what constitutes a 'real sensible possibility of conflict'[170] for a corporation acting as trustee? The decision process of the corporation is likely to be multi-layered and animated by multiple actors with multifarious agenda. This is similar to what the attribution rules described earlier were trying to resolve, but the evaluation here is more complex. The question is not 'who made the decision' but 'ought the courts assume that the company's ability to make a selfless decision was likely to be compromised?' Sometimes that will be simple to assess. More often though, the assessment will need to have regard for the hierarchies, processes and protocols giving structure and form to the decision within that corporation, and to whether they were effective in the instant case.

In more concrete terms, does the presence of governance processes, such as disclosure, transparency, audit and remuneration committees and independent directorships, immunise the institution from the particular conflict, or do those processes themselves have to be evaluated for their robustness? The latter would seem to be the conclusion from the Maxwell pension fund scandal in the UK in the 1990s[171] and from cases seen in other

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169 *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32, in which Lindsay J cites Watson LJ in *Bray v. Ford* [1896] A.C. 44.

170 *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41, 611, citing *Phipps v Boardman* [1965] 2 AC 46 .

171 A brief summary of the scandal and the findings of the parliamentary committee it inspired is contained in Paul Klumpes, 'Maxwell and the Accountability of Superannuation Schemes in Australia: A Critical Review of Law Reform' (1993) 21 *Australian Business Law Review* 194.

financial services contexts, such as investment banking.[172] There courts have been prepared to recognise the value of procedural measures such as information firewalls in managing conflicts,[173] but only on a case-by-case basis. The issue has not been analysed in any detail by an Australian court in the superannuation context.

Again, then, the conclusion is that legal rules that implicitly rely on an anthropomorphic mode of reasoning risk not engaging effectively with the organisational realities of the institution (the corporate trustee) being regulated.

The response of the regulatory scheme to the problem

As with the vulnerabilities identified in Part 4.2, there are a variety of ways in which the regulatory scheme attempts to repair the potential gap in the regulatory tapestry caused by the dislocation in the axis of accountability between the individuals responsible for making decisions on behalf of members and the members themselves. Some are present in trust law, but for the most part they are injected into the regulatory scheme by statute.

Accessorial liability under general law

One way an individual may be held accountable for a breach by the corporate trustee is that officers of the trustee, whether directors or not, may be found to have accessorial liability for a breach of trust by the corporate trustee under the 'knowing assistance' limb of the rule in *Barnes v Addy*.[174] Under that rule, third parties (such as directors of a corporate trustee) can be liable to beneficiaries if they:

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172 For a discussion in respect of investment banks, see Andrew Tuch, 'Investment Banks as Fiduciaries: Implications for Conflicts of Interest' (2005) 29 *Melbourne University Law Review* 478.

173 *ASIC v Citigroup Global Markets Australia Ltd* [2007] FCA 963. See also Pamela Hanrahan, '*ASIC v Citigroup*: Investment banks, conflicts of interest, and Chinese walls' in Justin O'Brien (ed), *Private Equity, Corporate Governance and the Dynamics of Capital Market Regulation* (Imperial College Press, 2007).

174 (1874) LR 9 Ch App 244. See in respect of the funds management/superannuation context: Pamela Hanrahan, *Funds Management in Australia. Officers' Duties and Liabilities* (LexisNexis Butterworths, 2007), [11.18 – 11.25]. More generally, there is a voluminous literature concerning the ambit of this rule that need not distract us here. Recent contributions include Rob Chambers, 'Knowing receipt: Frozen in Australia' (2007) 2 *Journal of Equity* 40; Matthew Harding, 'Two fiduciary fallacies' (2007) 2 *Journal of Equity* 1.

> assist with knowledge in a dishonest and fraudulent design on the part of the trustees[175]

This has obvious relevance to the superannuation context. As Finn J noted in *ASC v AS Nominees:*

> this form of liability is of no little significance to the directors of a trust company for the very reason that, often enough, it will be their own conduct in exercising the powers of the board which causes their company to commit a breach of trust.[176]

Despite Finn J's obvious enthusiasm for the rule, it must be owned that its application is circumscribed by its limitation to breaches in which the trustee had knowledge of a 'dishonest and fraudulent' design.[177] So it may not cover the full range of possible breaches of trust for which a member might be minded to seek a remedy. There is also Australian authority[178] to suggest that it is only available to remedy a breach of a fiduciary obligation and might therefore not be available in respect of breaches by a trustee of other equitable duties such as a want of diligence or care[179] This would however seem to have been overtaken by High Court authority[180] that either a breach of trust or a breach fiduciary of

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175 Above n 174, 251.

176 (1995) 133 ALR 1,19.

177 *Super 1000 v Pacific General Securities* [2008] NSWSC 1222, [129]. But cf the High Court in *Farah Constructions v Saydee* (2007) 230 CLR 89, noting at [161] the existence of an earlier line of cases in which the trustee had not acted with an improper purpose. As the learned authors of *Jacobs Law of Trusts* note at [1334], the fact that such fact situations do not attract liability under the rule in *Barnes v Addy*, does not mean they will not attract the attention of the court as Lord Selborne LC's dictum was never intended to be an exhaustive enumeration of the grounds under which liability might attach; Dyson Heydon and Mark Leeming, *Jacobs Law of Trusts in Australia*, (7th edn, LexisNexis Butterworths, 2006).

178 *Farrow Finance Co Ltd (in liq) v Farrow Properties Pty Ltd (in liq)* (1997) 26 ACSR 544, 580.

179 On whether the duty of care owed by a company director is a 'fiduciary' duty or merely an equitable duty owed by a fiduciary (with the narrower range of remedies the latter characterisation attracts), see Dyson Heydon, 'Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Law Book Company, 2005), responding in part to Robert Austin, 'Moulding the Content of Fiduciary Duties', in A J Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon, 1996), 153.

180 *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Farah Constructions* (2007) 230 CLR 89, [160]. Note this conclusion is unaffected by the ongoing academic debate noted above.

duty will suffice.[181] There are so far no reported cases of this mechanism having been employed in the superannuation context.

Accessorial liability by s 55(3) of the SIS Act

It may also be possible to use s 55(3) of the *SIS Act* to mount an action against directors for accessorial liability for a breach occasioning loss or damage of one or more of the covenants included in the governing rules of the trust. That section provides

> (3) A person who suffers loss or damage as a result of conduct of another person that was engaged in contravention of [a covenant contained in the governing rules of a superannuation entity] may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.

On its face, s 55(3) gives aggrieved members standing to hold the director of a trustee company liable for a breach of the s 52 covenants (and other similar rules that the trust instrument may contain) if they can demonstrate that they have suffered loss or damage and that the other person was 'involved in' the contravention.

There are no reported cases considering the interpretation or application of this provision. The requirement for loss or damage should be uncontroversial. There is however some residual ambiguity around what is meant by being 'involved in' the contravention. The definition of the phrase 'involved in' was contained in s 17 of the *SIS Act*. That section was repealed in 2001.[182] In its stead, s 9A of the *SIS Act* provides that Chapter 2 of the *Criminal Code* (other than Part 2.5) applies to all offences created by the *SIS Act*. There are two obvious problems. The first is that *Criminal Code* does not specifically define the phrase 'involved in'. Perhaps the phrase is to be taken to be encompassed by Division 11 of Chapter 2 of the *Criminal Code* which provides that:

> 11.2 Complicity and common purpose
>
> A person who aids, abets, counsels or procures the commission of an offence by another person is taken to have committed that offence and is punishable accordingly.

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181 A similar view was taken by the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97.

182 *Treasury Legislation Amendment (Application of Criminal Code) Act (No. 1) 2001* (Cth)

That seems an unsupported leap in logic. It underestimates the complexity and nuance surrounding issues such as causality and knowledge in the area of accessorial liability.[183] Moreover 11.2 appears to do too much: it doesn't simply define what is meant by involvement in a contravention, it actually creates the liability. On its face it eclipses s55(3) all together.

Perhaps the most telling criticism of the approach taken in s 9A, however, is that breach of a covenant would ordinarily in trust law only give rise to civil liability on the part of the trustee, with the remedial consequences that entails. Section 9A therefore appears to transform the civil action available to members under s 55(3) into something entirely different. It would indeed be odd if the principles applicable to 'complicity' in criminal acts were to be applied to this inherently civil matter. Again, there is nothing available to guide resolution of that conundrum.

Vicarious liability under s 52(8) of the SIS Act

Finally, it may be possible to identify a form of vicarious liability to link individual directors to a default by the trustee corporation in such a way as to give the members of the fund a right of action.

At general law, the courts would be highly unlikely to draw such a link. The members' right of action is against the trustee, not its officers, unless some accessorial basis for liability can be found. The courts in Australia are notoriously reluctant to 'pierce' the veil.[184] The strong statutory direction encouraging trustees of superannuation funds to incorporate would be an effective counter to any claim that the corporation was a mere 'sham' designed to defraud creditors or other stakeholders.[185]

The *SIS Act* goes some way to addressing the issue, but perhaps not as far as some have assumed. Section 52(8) provides:

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183 For a discussion of some of these issues in another area (s75B of the Trade Practices Act 1974 (Cth)) in which the phrase 'involved in' was used see Brent Michael, 'Must an accessory be a know-it-all?' (2010) 18 *Trade Practices Law Journal* 234.

184 See, for instance, the discussion in *Briggs v James Hardie* (1989) 16 NSWLR 549, especially 567 – 580 (Rogers AJA).

185 The 'sham' cases are discussed in Murray Pickering, 'The Company as a Separate Legal Entity' (1968) 31 *Modern Law Review* 481.

> *'Covenant by corporate trustee has effect as covenant by trustee's directors*
>
> > (8) A covenant by a corporate trustee of a superannuation entity that is to the effect of a covenant referred to in subsection (2) ... also operates as a covenant by each of the directors of the trustee to exercise a reasonable degree of care and diligence for the purposes of ensuring that the trustee carries out the first-mentioned covenant, and so operates as if the directors were parties to the governing rules.'

That is to say, the directors each owe a duty to exercise care to ensure that the corporate trustee meets its obligations under the covenants in s 52(2). In the event of a breach of trust on the part of the trustee a member could potentially seek redress from the individual director or directors. They could do so directly under the trust instrument, or by recourse to the (problematic) application of s 55(3).

There are two problems with this in practice. First, the duty imposed by s 52(8) is not as strict as it might appear at first blush. Individual directors are only required to act with care and diligence 'for the purposes of ensuring' that the trustee meets its obligations. They are not required actually to ensure that the trustee actually meets its obligations. This perhaps reflects the fact that individual directors have very limited ability themselves to ensure that a trustee company does or does not do something; they act collectively as a Board.

The other problem is the familiar problem of attribution. Section 338 of the *SIS Act* is relevant in this regard. It provides:

> *State of mind of body corporate*
>
> (1) If, in proceedings for an offence against this Act, it is necessary to establish the state of mind of a body corporate in relation to particular conduct, it is sufficient to show:
>
> > (a) that the conduct was engaged in by a director, servant or agent of the body corporate within the scope of actual or apparent authority; and
> >
> > (b) that the director, servant or agent had the state of mind.

On close examination, this purported rule of attribution is however of very limited use, at least in respect of directors. It fails to recognise that instances of directors acting themselves are likely to be rare in the superannuation context. Most of the decisions taken by trustees will be animated not by a single human actor, but a combination of actors, perhaps in Board or sub-committee deliberations. Section 338 is not readily amenable to interpretation when the individual's state of mind is just one in a collective decision.

Finally, it is hard enough to demonstrate causality between complex, ongoing deliberative processes such as the formulation of an investment strategy or the appointment of an agent, and financial outcomes. This connection will inevitably be even harder to draw when the onus is on the member to prove a deficiency of care where there is a significant asymmetry of information such as that which exists in a trust environment. As will be discussed in Chapter 9, the muscularity of trust law's standards is not matched by mechanisms, such as the availability of information, that would enable beneficiaries to hold trustees to those demanding standards, and the *SIS Act* does little to address this asymmetry of information.

Again, then, the *SIS Act* demonstrates that policy makers and legislators are aware of the dislocation of the axis of responsibility between director and member that arises as a result of the interposition of the corporate form as trustee of a superannuation fund. They have attempted to use statutory means to replicate the exacting standards and accountability present in the paradigmatic trust model.

The analysis presented above demonstrates that this approach has only been partly effective in achieving this objective. Thus, although the statutory provisions analysed in this Part serve to illustrate the important symbiosis between trust law and statute in the regulatory scheme, they also highlight the difficulties in using statute to replicate precisely the outcomes achieved in trust law, a theme that is discussed in more detail and further instantiated in Chapter 5 below.

Concluding comments

This Chapter has described the way in which trust law provides the legal infrastructure for the key institution in the superannuation system, the superannuation fund.

There are challenges in identifying from the public record why trust law was chosen to play this role. However this need not detract from the basic conclusion that the choice was a sound one. Trust law quarantines the assets of the fund from both the sponsoring employer and the employee/member, helping to ensure that the assets are appropriately preserved to finance the member's retirement. It also locates responsibility for administering the fund in a single place, which both facilitates administration of the fund from a practical perspective and focuses accountability from a regulatory perspective. Finally, it is also inherently flexible, and hence able to accommodate variation, differentiation and evolution without losing its fundamental characteristics.

The Chapter also identified a number of limitations of trust law relevant to this infrastructure role. It highlighted that despite the protective aura of trust law, trust law itself does not establish a definitive balance between the interests of the parties. That balance depends, in the first instance, on the terms of the trust instrument, which exposes members to the risk of self-interested drafting by those establishing the fund. It also highlighted that the interposition of a corporation as trustee for a superannuation fund has a disruptive and corrosive effect on a key element of the substantivity of trust law: the axis of accountability between the decision makers and beneficiaries. As we have seen, both limitations have inspired legislative responses, but as has also been demonstrated, at present those responses do not appear to go far enough to resolve the issues identified.[186]

Overall, then, the Chapter demonstrates that the regulatory system derives focus and instrumental capacity from being able to harness trust law to provide the infrastructure for the institutional structure of the key entities in the system.

[186] Postscript: key legislative measures designed to address some of these unresolved shortcomings have been introduced to Parliament, in large part as a result of the analysis contained in this Thesis. As of 30 June 2012 the Bills have not been passed.

Chapter 5

Trust law's interpretive role

'Where words have been used which have acquired a legal meaning it will be taken, prima facie, that the legislature has intended to use them with that meaning unless a contrary intention clearly appears from the context.'

O'Connor J in *Attorney General of NSW v Brewery Employees Union of NSW*[1]

The second role played by trust law is where specific words and phrases in the statutory framework are interpreted by reference to the specialized connotations they bear in trust law. This interpretive role is perhaps the most obvious type of inter-legality presented in this Thesis because it expressly acknowledges the relationship between trust law and statute.

Employing terms that are familiar to the general law is a strategy of statutory drafting that potentially brings instant richness to the regulatory scheme. It imbues the regulatory scheme with the interpretations and connotations, and hence to some extent the substantivity, that are present in the general law. The strategy is also attended with several risks. The first is that the general law is not always identifiable in an unambiguous way. The second is that of ossification; the risk that the principles as articulated in statutory form do not keep pace with the development of the general law or with changes in the practical environment to which they are applied.

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1 (1908) 6 CLR 469, 531.

The chapter proceeds as follows. Part 5.1 analyses the relationship between the *SIS Act* and trust law. Part 5.2 then assesses the advantages and disadvantages of relying on trust law for interpretive meaning. Finally, Parts 5.3, 5.4 and 5.5 examine three important provisions in the *SIS Act* that illustrate the issues raised in Parts 5.1 and 5.2:

s 52(2)(c) - the requirement that a trustee act with the care, skill and diligence of a prudent person;

s 52(2)(b) – the duty of trustees to act in the 'best interests' of beneficiaries; and

s 62 - the sole purpose test.

The analysis in this chapter thus elaborates and illustrates trust law's interpretive role. It also provides further examples of trust law's substantive contribution to the regulatory scheme shaping superannuation.

5.1 The relationship between the *SIS Act* and the general law

The *SIS Act* is the centerpiece of the regulatory scheme shaping superannuation. That said, the *SIS Act* was expressly never intended to exclude other sources of law from operation. As was noted in Chapter 3, s 350 of the *SIS Act* confirms this co-existence.

The relationship between the *SIS Act* and the general law, including trust law, goes beyond co-existence, though. Chapter 4 described the way in which the regulatory scheme, including the *SIS Act*, relies on trust law modalities such as the trustee and the trust instrument to provide the legal infrastructure for operation of the institutions administering the superannuation system. This chapter highlights a more reflexive, symbiotic aspect of the relationship. It identifies that the *SIS Act* deliberately employs words and phrases that carry quite specialized meanings in trust law in an attempt to incorporate the jurisprudence that underlies those meanings into the interpretation of the statutory provisions. In some cases, as we shall see, this connection has already been expressly made by the courts. However the relative scarcity of relevant case law, particularly at an appellate level, means that in some cases the connection can at this stage only be suggested or inferred.

The relationship between the s 52(2) covenants and the general law

The *SIS Act* employs terms familiar to trust law in a number of places.[2] Reference to 'best interests', to 'care, skill and diligence', to 'prudence' and to 'sole purpose' all appear, at first blush, to refer to familiar trust law principles.

Support for the conclusion that Parliament intended the statutory provisions to be interpreted in this light can be drawn from the assertion of the Treasurer of the day that the provisions are:

> essentially a clarification of the obligations already imposed by trust law[3]

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2 Productivity Commission, *Review of the Superannuation Industry* (2001)6.1.

Further support can be drawn from approach taken by the Companies and Securities Advisory Committee of the Law Reform Commission, whose 1992 report on the legal framework governing the operation of collective investment schemes,[4] had a considerable influence on the way the *SIS Act* was framed. That report recommended that legislation articulate a minimum set of fiduciary (sic) duties drawn from general law, from which the constituent documents of the trust would not be able to derogate.[5]

Finally the courts (admittedly almost all at first instance) have typically treated them as merely statutory expressions of analogous general law rules, able to be applied in combination with other general law principles.[6] A number of those cases, and the academic commentary they have inspired, are discussed in detail below.

Although the legislative intent would seem therefore to be clear, it is dangerous simply to assume that lexical similarities between legislative provisions and curial expressions of analogous general law rules imply an intention on the part of Parliament simply to replicate the general law rules. Perhaps the 'clarification' involved more than simply the transliteration of specific general law rules into statutory form. In that vein, Lehane, writing before his appointment to the Federal Court, offered the somewhat enigmatic observation that

> it is a pity that the provisions are cast in a way calculated to suggest to courts that something different [from simple codification of the general law duty] may have been intended.[7]

He did not elaborate.

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3 Dawkins, *Strengthening Super Security* (1992), 6. But see *R v Bolton; ex parte Beane* (1987) 162 CLR 514 and *Minister for Immigration and Multi-cultural Affairs v Tang Jia Xin* (1994) 125 ALR 203 for caution against over-reliance on such statements.

4 Law Reform Commission, Superannuation (1992).

5 Ibid, recommendation 9.1.

6 See for instance *Gilberg v SERF* [2008] NSWSC 1318.

7 John Lehane, 'Delegation of Trustees' Powers and Current Developments in Investment Funds Management' (1995) 7 *Bond Law Review* 36.

To similar effect, Finn J in *Australian Securities Commission v AS Nominees*[8] noted in respect of the s 52(2) covenants

> These provisions *reflect, or are emanations of*, established common law rules. (emphasis added)[9]

Both possibilities, that the provisions 'reflected' or are 'emanations of' the common law rules, imply that, like Lehane, Finn J sees some lack of precise identity between the common law rules and the statutory provisions. However Finn J did not disclose what the differences are, nor did he elaborate on precisely what consequences would flow from this lack of congruence.

Finally, in *Invensys v Austrac,*[10] Byrne J was asked to apply s 52(2)(c); the duty on trustees to ensure that the their duties and powers are performed and exercised in the best interests of the funds' beneficiaries. His Honour's interpretation of the provision is discussed in more detail in Part 5.4 below, but it suffices here to note that implicit in his approach is acceptance that Parliament did indeed mean for the covenant to draw on the general law for content. Though noting that

> it is not altogether clear what is here being codified and whether the drafter of the code has accurately stated the existing law[11]

he went on to note

> The covenant ... appears to be an amalgam of two distinct obligations said to be imposed by law upon trustees of a superannuation fund.[12]

He then cited *Cowan v Scargill*[13] and *ABB Superannuation Fund v ABB,*[14] both cases where general law rules were applied by the courts. So Byrne J, too, appears to

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8 (1995) 133 ALR 1.

9 Ibid, 61.

10 *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Limited* [2006] VSC 112.

11 Ibid, [102].

12 Ibid, [107].

13 [1985] 1 Ch 270.

believe that regard for the general law principles is important in interpreting the content of the covenants, but is sensitive to the possibility of lexical inconsistency between s 52(2)(c) and the general law.

Should the s 52(2) covenants be seen as merely administrative rules?

In *re VBN*,[15] the Administrative Appeals Tribunal (AAT) advanced another possibility. The AAT in that case found that the covenants were not simply a restatement of the general law. Rather, after a detailed analysis of the genesis of the s 52(2) covenants, the AAT concluded

> that parliament intended to base the covenants in the *SIS Act* on those under the general law but to extend their ambit and to do so in an entirely new context[16]

With respect, this conclusion is unsupportable, and indeed the AAT's decision has been widely criticized by commentators.[17]

In essence, the AAT's decision in *re VBN* illustrates the difficulty of employing a 'purposive' approach to statutory interpretation in many commercial settings, something to which we will return below. The decision in *re VBN* contains a comprehensive description of the background to, and progress leading to, the enactment of the s 52(2) covenants. From this comprehensive and nuanced analysis the Tribunal drew the conclusion that

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14 *Asea Brown Boveri Superannuation Fund No.1 Pty Ltd v Asea Brown Boveri Pty Ltd* [1999] 1 VR 144. Note, the provisions of the *SIS Act* were not considered in this case because events at issue in the litigation antedated the enactment of the *SIS Act* in 1993.

15 [2006] AATA 710.

16 Ibid, [328].

17 See for instance Zein El Hasan and Phillip Turner 'APRA and the AXA Staff Plan Directors' (2006) 18 *Australian Superannuation Law Bulletin* 46; Ellen Liondis, 'Errors, breaches and convenants - common threads from the s 52(2) cases' (2007) 18 *Australian Superannuation Law Bulletin* 81; Daniel Mendoza-Jones, 'Superannuation trustees: Governance, best interests, conflicts of interest and the proposed reforms' (2012) 30 *Companies and Securities Law Journal* 297, 303.

> 'The cases in which the Trustee's duties were developed at general law was that of judicial supervision and so that of administrative law. It was not developed in the context of supervision by a Regulatory authority.[18]

Setting aside the solipsism of equating 'judicial supervision' with 'administrative law', it is clear that the AAT's conclusion relies on its placement of the s 52(2) covenants specifically within a regulatory framework.

This conclusion gains support from the fact that the *SIS Act* as a whole is designed to facilitate the regulation of the superannuation system.[19] Certainly the vast majority of provisions in the *SIS Act* have a regulatory character, encompassing issues such as licensing, APRA's role and powers, reporting requirements and the interface with the taxation system. However it is surprising that the AAT should regard the nature of the mechanism for enforcement (APRA, through its licensing power) as relevant to the calibration of the substantive content of the statutory provision, namely the standard of behaviour required from the trustees.

Just as surprising, the AAT's finding fails to recognize the inter-legal nature of the regulatory scheme shaping the superannuation system. As this Thesis documents, the regulatory scheme contains rules and principles from a variety of sources. The rules operate in a variety of ways and are also potentially enforced in a variety of different ways by different parties. The AAT appears implicitly to have assumed a much narrower definition of 'regulation' than this, one which operates purely through the state and its agencies. In so doing, the AAT's finding accords insufficient weight to the references to trust law that appear repeatedly in the ancillary materials so thoroughly reviewed by the AAT.

The AAT's finding also underestimates the importance of the signal sent by Parliament when it chose to impose the duties using the indirect mechanism of covenants implied into each trust's governing rules, rather than simply imposing a set of statutory duties directly. That mechanism distinguishes the covenants from

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18 Above n 15,[327].

19 Johns, *Hansard*, House of Representatives, 27 May 1993, 1101.

almost all the other regulatory provisions appearing in the *SIS Act*, a characteristic conspicuously underestimated by the AAT. It seems reasonable to conclude therefore that Parliament must be taken to have conceived of these rules as operating within the realm of trust law in making that choice.

The conclusion drawn here therefore is that whilst it is undoubtedly correct to say that the *SIS Act* is designed to facilitate the regulation of the superannuation system, it is important to recognize that it does so expressly and implicitly in combination with other juridical sources including (most relevantly for this Thesis) trust law.

Does the *SIS Act* 'codify' the prevailing trust law?

Finally, there is another possibility, correctly rejected in *re VBN*. It is worthy of brief mention nonetheless because, if it were supported, it would have important consequences for this Thesis. Perhaps the use made of trust law terms in the *SIS Act* should be characterised not simply as statutory 'drafting' but as 'codification'. Codification, in this sense, would mean that the provisions, whilst informed by the prevailing state of the general law, would eclipse and replace that law, re-expressing it in ways that capture its strengths but also correct perceived deficits.[20] Such a conclusion would severely limit the relevance of trust law in the superannuation environment.

There are however a number of reasons for believing that the *SIS Act* does not purport to 'codify' the trust law duties. First, that possibility was considered and expressly rejected by the Law Reform Committee in 1992. The Committee noted:

> The review did not intend to codify or alter the underlying equitable principles. The proposal was limited to the inclusion in legislation of a minimum set of duties that could not be derogated from by the deed or other constituting document. [21]

If more evidence is needed, the list of duties in the *SIS Act* is not a comprehensive list of even the most important of the equitable duties owed by trustees. It does not for

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20 See Roy Goode 'The Codification of Commercial Law' (1988) 14 *Monash University Law Review* 135 for an analogy with the US Uniform Commercial Code.

21 Law Reform Commission, *Superannuation* (1992), 9.16.

instance include a duty to obey the terms of the trust, a duty of impartiality or a duty to avoid conflicts of interests and conflicts of duties, all staples of trust law. Indeed tracking the list of what are variously described as the 'core,' 'essential' 'basic' or 'minimum' duties that appear in the analysis in the Law Reform Committee Report, through to the Committee's recommendations and then to the *SIS Act* highlights remarkable, but unexplained, inconsistencies.[22] Moreover the list that appears in the *SIS Act* is different again from that proposed by the group of experts[23] comprising the relevant sub-committee of the Special Premiers' Conference Working Party on non-Bank Financial Institutions, which the Law Reform Committee Report directly cites. In the final analysis the list of covenants specified in s 52(2) of the *SIS Act* contains only four of the eleven apparently 'non-negotiable' duties that had been identified along the way. No one seriously suggests that this means that those duties missing from the statute no longer apply, indeed there are judicial statements to the contrary.[24] It seems reasonable to conclude therefore that the *SIS Act* does not attempt to 'codify' the general law.

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22 These are discussed further below.

23 The group was indeed a Who's Who of Australian trust law at the time. It included Justice Meagher, Justice Gummow, Professor Emeritus HAJ Ford, Dr IJ Hardingham, and Professor PD Finn, amongst others.

24 For instance in relation to the duty of impartiality, see: *Collins v AMP Superannuation Ltd* (1997) 147 ALR 243; *Re VBN* [2006] AATA 710; *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204.

The challenge of employing a 'purposive' approach

A short digression is required before we can proceed to a provisional conclusion on the relationship between the SIS Act and trust law. There is a trend in modern statutory interpretation towards what is termed a 'purposive' approach.[25] This approach aims to elicit clarity on the appropriate interpretation of statutory provisions from the broader context in which the statute appears, including statements of policy appearing in extrinsic documents.[26] The question posed here is what, if any, contribution can such an approach make to the interpretation of the *SIS Act*?

That is not an easy question to answer. Tempting though it is to assume that the aim of the *SIS Act* is to protect member interests, as was noted in Chapter 2, the regulatory scheme shaping superannuation is in fact animated by the pursuit of two competing objectives; 'member protection' and 'efficiency'. This means that it would be unwise to assume the courts will necessarily take a member-friendly stance in interpreting provisions of the *SIS Act*. Rather the courts will need in any case before them to infer the balance Parliament sought to achieve. This may, for instance, constrain the courts from imposing too high a standard of skill on the part of trustees. As will be discussed in Part 5.3, in requiring 'equal representation',[27] Parliament clearly intended to encourage diligent lay participation on trustee boards. So a member-oriented inclination to require high standards of technical skill might be tempered by recognition of the value of lay engagement in the governance of

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25 See for instance Dimity Kingsford Smith, 'Interpreting the Corporations Law – Purpose, Practical Reasoning and the Public Interest' (1999) 21 *Sydney Law Review* 175.

26 Though this approach is consistent with s 15AA of the *Acts Interpretation Act 1901* (Cth), it actually goes further than that, since s 15AA only applies in the case of ambiguity. Notably, there is no equivalent to s 109H of the *Corporations Act* in the *SIS Act*.

27 The provisions imposing various permutations of this obligation on funds according to their circumstances appear in Part 9 of the *SIS Act*.

superannuation funds.[28] Similarly, as we shall see in Part 5.4, there is an argument that the provision of wide-ranging member investment choice within a fund, which would appear to promote the efficiency objective in so far as it permits individual members to craft investment strategies tailored to their precise needs, must be weighed against the overwhelming evidence that most individuals make such choices badly. Promotion of the member protection objective might in that case extend to saving members from making self-harming investment choices.[29] Again the courts will need to identify how the competing interests are to be balanced in light of a regulatory scheme with multiple objectives, the balance between which is inevitably contingent and nuanced. The presence of trust law, directly in its infrastructure role and indirectly in its other roles, ensures that the substantivity of trust law is incorporated into this assessment.

A provisional conclusion?

The courts have yet to provide a definitive answer to the question of the precise relationship between the general law and the duties covenanted in s 52(2) of the *SIS Act*. The approach of the courts in *ASC v AS Nominees*[30] and in *Invensys*[31] suggests a relationship between the general law and the statutory provisions that, while close, falls short of a precise mapping from one to the other. Moreover, although respect ought to be paid to the thoroughness of the 'purposive' approach employed by the AAT in interpreting the s 52(2) covenants in *re VBN*,[32] it is suggested here that little reliance be placed on that particular case.

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[28] Scott Donald, 'The competence and diligence required of trustees of a 21st century superannuation fund' (2009) 37 *Australian Business Law Review* 50.

[29] Indeed this is the position that APRA appears to be taking currently; APRA, *Superannuation Circular No. II.D.1: Managing Investments and Investment Choice* (2006). For further discussion on this subject, see Scott Donald, 'The prudent eunuch: Superannuation trusteeship and member investment choice' (2008) 19 *Journal of Business and Finance Law and Practice* 5.

[30] Above n 8.

[31] Above n 10.

[32] Above n 15.

The conclusion reached in this Thesis most closely resembles that expressed by Finn J in *ASC v AS Nominees*,[33] namely that the statutory provisions are not simply replicas of the general law. Neither are they formal 'codification'. The provisions are each informed by the general law, but need also to be interpreted in the context of a modern superannuation fund. Parliament drew on familiar trust law concepts to provide guidance to trustees and regulators on what it regarded as appropriate standards of conduct for trustees. In part this was motivated by a desire to provide clarity and certainty to trustees, members and regulators, but the legislative intervention was crucially also designed to ensure those duties were secured against possible erosion through private negotiation.

The analysis contained in Part 5.3, 5.4 and 5.5 supports this conclusion. Those Parts examine in detail three provisions key provisions of the *SIS Act* and examine their possible application to real world situations. Taken together, the analysis suggests that trust law *can* and *should* inform the interpretation of each of the statutory provisions, underscoring the broader thesis presented here that trust law has a valuable, complementary role to play in the regulatory scheme shaping superannuation. It reaches this conclusion notwithstanding ambiguities and uncertainties in the general law and flaws in the drafting of the statutory provisions. It also recognizes several broader issues concerned with the use of general law principles within a statutory framework. At this point it is therefore appropriate to identify some of those broader issues and thereby set the scene for the detailed discussion that occurs in Parts 5.3, 5.4 and 5.5.

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33 Above n 8.

5.2 Consequences of using trust law to inform statutory provisions

Legislation often employs concepts and terminology familiar to the general law. As a strategy of legislative drafting, this approach has some strengths. As Gray and Hamilton note, it harnesses the accumulation of jurisprudence relevant to the phrase in the service of making the provision understood.[34] In so doing, it potentially brings instant richness to the scheme. The jurisprudence injected into the scheme in this manner has been honed over time by repeated curial deliberation. The statutory provision can inherit the fruits of that deliberation. In particular, in creating the jurisprudence, the courts have had to generate the nuances and contingencies in doctrine necessary to make the rules effective.

The strategy of using trust law terms in the legislation also has the virtue that the jurisprudence so injected into the regulatory scheme is familiar to the subjects of the regulation. It does not require new terms or concepts to be defined. This, in theory at least, facilitates parsimonious legislative drafting. Moreover, to the extent that the drafting is faithful to the content of extant general law, familiarity reduces implementation friction when the legislation comes into force. The value of these seemingly pragmatic considerations should not be underestimated; they are repeatedly advanced as reasons for the retention of trust law in the superannuation context.[35]

Finally, placement of a general law rule in statutory form renders it more accessible to interested lay people than is likely to be the case for rules derived from (but

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34 Joanna Gray and Jenny Hamilton, *Implementing Financial Regulation* (Wiley, 2006), 242.

35 See for instance the submission to the Cooper Review from the Association of Superannuation Funds of Australia (16 October 2009), at 3. But cf the submission by IFSA highlighting the way uncertainty in the relationship between the *SIS Act* and the general law has undermined the efficacy of the regulatory scheme; Investment and Financial Services Association (25 August 2009) at 29-30. Both submissions available at http://www.supersystemreview.gov.au.

embedded within) case law. As the Productivity Commission noted in its review into the efficiency of the regulatory scheme:

> codification [sic] provides greater transparency and certainty with respect to what must be done by a trustee. As such, rights to civil action for loss or damage due to breach of the covenant may be more easy to establish.[36]

The strategy is however not without its risks. Two generic risks are described below: the challenge of ensuring that the rule retains its meaning when transliterated from the general law into statute, and the risk of anachronism arising from the ossification of the rule when it is articulated in statutory form.

Transliteration

The strategy of injecting general law rules directly into statute relies on the terms employed being unambiguously defined in the general law. As we shall see in Part 5.4, where the 'best interests' covenant is examined in detail, this can be problematic.

The success of the strategy also requires that the terms be employed in the same way. This problem is encountered in Part 5.5 with respect to the 'sole purpose' requirement of s 62 of the *SIS Act,* which appears to be evoking the rules relating to donees' exercise of powers but which on closer examination is found to have a more ambiguous relationship to the general law rules.

Where such unanimity of meaning and/or use is not present, placing the term in a statute such as the *SIS Act* risks adding another level of complexity. As we saw above, this potential was realized in the case of *Re VBN*, where the AAT sought to interpret the s 52(2) covenants in light of their 'administrative' law context.

There is also the possibility that legislators will seek to be overly prescriptive, perhaps from fear of judicial activism or from a desire to constrain the autonomy granted to regulatory bodies. The result can be a legal environment in which the

[36] Productivity Commission, *Review of the Superannuation Industry* (2001), 127.

profusion of detail overwhelms the underlying principles.[37] As Sir Anthony Mason noted in respect of what was s 52A of the *Trade Practices Act:*

> 'the dilemma which faces the draftsman of a statute who seeks to introduce an equitable concept in the Elysian fields of commerce. Striving for that degree of certainty which commercial men constantly demand from others but rarely provide in their own arrangements for themselves, the draftsman endeavours to spell out all the relevant considerations, depriving the court of important areas of choice by assigning to it the mechanistic interpretation of the statute.[38]

Importantly this risk cannot necessarily be avoided simply by restating the rule in precisely the same terms as it appears in the general law (even assuming such is possible). As Diver,[39] Black[40] and others[41] outline, there is a need to ensure that the form of the provision reflects the context in which it is to be applied. It is quite possible, for instance, that the form taken by rules developed in the context of family and testamentary trusts may be inappropriate in a commercial or public policy setting such as that of a large scale superannuation fund.[42] Black, in particular, is

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37 Ian Ramsay, 'Corporate Law in the Age of Statute', (1992) 14 *Sydney Law Review* 474. The optimal specificity of rules has attracted much interest from theorists in the Law and Economics tradition. See for instance Louis Kaplow 'A Model of the Optimal Complexity of Legal Rules' (1995) 11 *Journal of Law, Economics and Organization* 150, and more recently Yuval Feldman and Alon Harel, 'Social Norms, Self Interest and Legal Norms: An Experimental Analysis of the Rule vs Standard Dilemma' (2008) 4(1) *Review of Law and Economics* 81.

38 Sir Anthony Mason, 'Themes and Prospects', in Paul Finn, (ed), *Essays in Equity* (LawBook Company, 1985), 243-4.

39 Colin Diver, 'The Optimal Precision of Administrative Rules' (1983-4) 93 *Yale Law Journal* 65.

40 Julia Black, 'Which Arrow? Rule Type and Regulatory Policy' (1995) *Public Law* 94.

41 See for instance J M Green, '"Fuzzy Law"; a better way to stop "snouts in the trough"' (1991) 9 *Company and Securities Law Journal* 144.

42 Of course, as we saw above, this applies equally to the *content* of general law rules drawn from different contexts. See for instance the comments of Bryson J in *Dillon v Burns Philp Finance Ltd* (Unreported, Supreme Court of New South Wales, Bryson J, 20 July 1988), 14; *Vidovic v Email Superannuation* (Unreported, Supreme Court of New South Wales, Bryson J, 3 March 1995); and *Sayseng v Kellogg Superannuation Pty Ltd*[2003] NSWSC 945, [59].

concerned to emphasise the risk that overly complex rules will undermine the shared understanding required to make principles-based regulation work in the competitive financial services industry.[43] So, for instance, the list-based approach to trustee investments may prove very effective in a Victorian context where trustees were amateur, inexpert, part-time and unpaid, but as Part 5.3 shows, it is arguably far less appropriate in the context of a modern superannuation fund.

The form of the rule therefore matters. This in turn means that there will be areas which are well-suited to rules articulated in the form in which trust law is articulated, and some which are not. This insight, which reflects Black's analysis of contemporary regulatory systems, is important to this Thesis. Most importantly, it correlates with trust law's traditional reliance on principles rather than tight-knit and inflexible rules, an issue discussed in detail in Chapter 6, and with the exhortative tone often used by the courts in describing the rules, an issue discussed in detail in Chapter 7.

Anachronism

The success of the strategy of adopting terms from trust law also depends on the ability of the terms to retain contemporary relevance. This problem is of course not unique to the strategy of employing terms from trust law. Gummow, quoting Bennion, notes:

> Each generation lives under the law it inherits. Constant formal updating is not practicable, so an Act takes on a life of its own ... Viewed like this, the ongoing Act resembles a vessel launched on some one-way voyage from the old world to the new. The vessel is not going to return; nor are its passengers. Having only what they set out with, they cope as best they can. On arrival in the present, they deploy their native endowments under conditions originally unguessed at.[44]

He goes on to add:

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43 Julia Black, 'Forms and paradoxes of principles-based regulation' (2008) 3(4) *Capital Markets Law Journal* 425, 438.

44 William Gummow, *Change and Continuity. Statute, Equity and Federalism*, (1999, Oxford, OUP), 6 – 7.

> This description is particularly apt to illustrate the situation where statute takes a particular common law doctrine as a criterion for its operation. The scope and purpose of the statute will expand, contract and diversify to follow the shifts in the common law. In this way, the common law gives to the statute a dynamic operation which, if differently expressed, the statute might not have had.[45]

That is to say, attaching the legislated standards to a body of law that is evolving (such as trust law) enhances its ability to stay relevant to evolving societal norms and market structures. The use of the hypothetical 'prudent person' as a benchmark for the standard of care, skill and diligence required of a trustee in the exercise of its powers and the execution of its duties, is a good example of this. As is discussed in detail in Part 5.3, the 'prudent person' standard enables the court to calibrate the rule as it applies to the exercise of the investment power with reference to contemporary views on investment 'best practice,' ensuring that the substance of the regulation scheme remains relevant.

[45] Ibid.

5.3 The duty to act with the care, skill and diligence of a prudent person

Chapter 4 mapped the ways in which trust law ensures that trustees are responsible for the administration of superannuation funds. For obvious reasons, the quality of that administration is extremely important both at a local and at a systemic level. Failure by a trustee to act with care, skill and diligence increases the risk of loss by the trust; a loss which if occasioned, the courts have the opportunity to require the trustee to remediate.

Section 52(2)(b) of the *SIS Act* is thus an important element of the regulatory scheme. The covenant imposed on the governing rules of all superannuation funds by s 52(2)(b) requires that each trustee

> 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

Like the covenant imposed by s 52(2)(c), which is discussed in Part 5.4 below, this covenant echoes a requirement imposed by trust law. And like s 52(2)(c), it does so imprecisely.

This Part focuses on three aspects of this covenant. First it examines the notion of 'prudence', noting that behind the apparent simplicity of that term lie nuances of meaning of considerable import for trustees in the exercise of their investment powers. It next considers the implications of the use of the term 'person' when the general law standard on which the provision is based refers to a 'business person'. The departure in terminology from that generally employed in trust law implies a difference in the required intensity and nature of the requirement and must be seen to reflect a deliberate policy choice by Parliament. The Part then briefly addresses the reference to 'diligence,' recognizing that, in a reminder of the analysis in Chapter 4, the interposition of a corporate form as trustee undermines the motive force of this requirement.

Finally, the Practical examples presented at the end of this Part demonstrate that s 52(2)(b) is capable of assimilating contemporary ideas on investment into the standards required of superannuation fund trustees. Such an assimilation would have the effect of incorporating more nuanced, sophisticated notions of risk into the requirements imposed on the trustees of superannuation funds.

Overall, then, the analysis in this Part demonstrates that interpreting s 52(2)(b) in light of the equivalent trust law requirements injects into the regulatory scheme not just a set of standards but more importantly a modality of connection to contemporary technologies that ensures that the standard applied evolves as contemporary technology evolves.

The Statutory Covenant

Section 52 of the *SIS Act* provides:

> (1) If the governing rules of a superannuation entity do not contain covenants to the effect of the covenants set out in subsection (2), those governing rules are taken to contain covenants to that effect ...
>
> (2) The covenants referred to in subsection (1) are the following covenants by each trustee of the entity: ...
>
> (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;

The covenant imposed by s 52(2)(b) plays an important part in securing Parliament's intention of creating a regulatory environment that, as Finn J describes it in *ASC v AS Nominees*:

> [protects] investors from abuses of trust by ensuring proper standards are maintained in trust management and in trustee behaviour. [46]

Importantly it guides rather than prescribes. It is also complementary to other statutory provisions, including but not limited to, those discussed in Parts 5.4 and 5.5.

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[46] *ASC v AS Nominees* (1995) 133 ALR 1, 61.

Before proceeding to the detailed analysis of the covenant, it is worth noting that, like the other statutory provisions analysed in this Chapter, the s 52(2)(b) requirement to exercise the care, skill and diligence of a prudent person applies broadly. The covenant is expressly defined to apply across 'all matters affecting the entity'. Thus, although much of the discussion below addresses the application of the requirement in relation to the exercise of the trustee's investment powers, the requirement is not limited to that context. It does, for instance, arise in respect of member-related decisions, such as the determination of TPD claims,[47] calculation and communication of crediting rates[48] and other member-benefit issues.

Analysis of the Statutory Duty

Section 52(2)(b) contains a number of terms that are familiar to trust law. There seems little doubt that Parliament intended the connotations those terms carry in the general law to apply here.[49] That said, there are lexical differences between the way that the general law is usually articulated and the text of the provision. In this context it is argued that the divergences are deliberate.[50] Parliament appears to be signaling a departure from the standards imposed by trust law, the need for which is founded in public policy considerations.

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47 *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204.

48 See, for instance *Re VBN* [2006] AATA 710.

49 *Manglicmot*, above n 47, [120].

50 In contrast, Part 5.4 below finds that Parliament's adoption in s 52(2)(c) of the protologistic duty to act in the 'best interests' of members was ignorant of the heterodoxy it represented.

Defining 'prudence'

The question of what constitutes 'prudence' in a trust context is one of the few areas of law canvassed in this Thesis where there is already an extensive body of academic analysis.[51] Much of this literature focuses on prudence in the context of the investment powers and duties of trustees. On the whole, the literature is critical of what its authors perceive to be the outdated attitudes taken by the courts in respect of trustees exposing their trusts to investment risk.

The analysis presented here is less damning, and indeed identifies the potential to develop a highly sophisticated, nuanced and dynamic jurisprudence in this area. Importantly for this Thesis, this enhanced approach is entirely consistent with the attitudes and approach traditionally adopted by the courts in the general law. It thus supports the broader hypothesis that trust law is an effective and complementary contributor to the regulatory scheme shaping superannuation.

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51 There is a daunting array of learned commentary on the application of finance theory to trust law, most of it originating in the US (where specific statutory initiatives have to be factored into consideration). In Australia, see for instance Allan McDougall, 'The Prudent Trustee, Managed Funds and the Commonwealth Superannuation Industry (Superannuation) Act 1993' (1996) 7 *Journal of Banking and Finance Law and Practice* 93; Mark Adams, 'Practical Issues in the Application of Trust Fund Moneys in the Use of Derivatives' (1994) 5 *Journal of Banking and Finance Law and Practice* 20; Frank Finn and Paul Zeigler, 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' 1987 (61) *Australian Law Journal* 329; W A Lee, 'Modern Portfolio Theory and the Investment of Pension Funds', in Paul Finn (ed), *Equity and Commercial Relationships*, (Law Book Company, 1987). Also Paul Ali, Geof Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries*, (Law Book Company, 2003). Jeffrey Gordon 'The Puzzling Persistence of the Constrained Prudent Man Rule' (1987) 62 *New York University Law Review* 52, and Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule*, (OUP, 1986) have also been extremely influential, notwithstanding their US perspective.

The starting point is to recognize that trust law contains not one but two distinct sets of cases relating to prudence.[52] The first line of cases relates directly to the quality of care exhibited by the trustee. The second relates more specifically to the nature of the investment selected for the trust by the trustee. This distinction helps to explain several judicial comments that might otherwise seem dissonant. More importantly, it also helps to clarify what is expected today of the trustees of superannuation funds in respect of their investment responsibilities.

Prudence as caution and the avoidance of recklessness

The first line of cases arises where, stated loosely, the breach arises from deficiencies in the way in which the trustees executed their duties. The quality of the trustees' action (or inaction) in this line of cases is sometimes characterised as 'speculation'[53] or, in extreme cases, is attributed to 'recklessness'.[54] These terms have never been adequately defined and it is hard not to sympathize with Johnson's description (applied to the US context but equally applicable here) of 'speculation' as the 'prudent person's slipperiest term of art.'[55]

The want of care exhibited by the trustee need not however warrant such colourful language. Indeed the moral tone of such language can be distracting as the breaches alleged to have occurred are often entirely mundane, attributable more to a lack of diligence than anything more sinister.[56] The trustee who fails to secure adequate

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52 This argument is advanced in more detail than in possible here in Scott Donald, 'Prudence under Pressure' (2010) 4 *Journal of Equity* 44.

53 *Doneley v Doneley* [1998] Qd R 602; *Bartlett v Barclays Bank Trust Co* [1980] Ch 515.

54 *Wilkinson v Feldworth Financial Services Pty Ltd* (1998) 29 ACSR 642; *ASIC v Parker* [2003] FCA 262, [112].

55 Michael Johnson, 'Speculating on the Efficiency of Speculation: An Analysis of the Prudent Person's Slipperiest Term of Art in Light of Modern Portfolio Theory' (1995) 48 *Stanford Law Review* 419.

56 See for instance *In re Turner* [1897] 1 Ch 536 in which the root cause of the breach would appear to have been reliance on the probity of a co-trustee, and *Smethurst v Hastings (*1885) 30 ChD 490 where there was a general lack of enquiry, which enquiry would have identified the deficiencies of the investment proposed. There are however cases like *Re Smith* [1896] 1 Ch 71, in which the moral probity of one

security for a loan made from trust monies is the epitome of this line of cases.[57] Other examples include inadequate diligence in following up outstanding debts owed by mortgagees,[58] failure to supervise adequately the affairs of a privately held business,[59] and failure to secure an independent valuation.[60] There has also been criticism of trustees' failure to employ adequate operational safeguards in the handling of trust cashflows and assets.[61]

Often it is not a single act or omission that attracts the disapproval of the court. It may instead be a pattern of deficiency, some of the lapses immaterial but nevertheless contributing to an impression of an overall want of care. In *ASC v AS Nominees,*[62] for example, the trustee was found to have breached its duty for (amongst a litany of breaches) failure to pursue a defaulting loan, undue haste in making a decision, failure to achieve adequate security on a loan and an overall 'laxity of supervision'.

Although these cases span several centuries and a wide range of circumstances, the common element is the court's focus on the conduct of the trustee. The language used by the courts in some of the reported cases suggests attention to the actual

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trustee was found wanting. The court in that case was careful to clarify that the investment in an unsecured mortgage was impugned not because the security was inadequate but because one of the trustees had acted dishonestly in accepting a bribe in relation to the investment.

57 *Holmes v Dring* [1788] 2 Cox 1; 30 ER 1; *Mills v Osborne* [1834] 7 Sim 30; 58 ER 748; *Re Salmon* (1889) 42 Ch D 351; *Fouche v Superannuation Board* (1952) 88 CLR 609; *ASIC v Parker*, above n 54.

58 *Fouche v Superannuation Board* above n 57.

59 *Re Lucking's Will Trusts* [1967] 3 All ER 726.

60 *Smith v Hassall* (1899) 22 LR (NSW) Eq 165; *ASIC v Parker*, above n 54.

61 *Re Preuss and APRA* [2005] AATA 748. See also *Knight v Earl of Plymouth* [1747] 3 Atk 480; 21 ER 214 in which the court recognised that the loss to the trust resulting from the insolvency of the originator of bills sold to the trust did not of itself taint the otherwise prudent handling of cashflows by the receiver responsible for administering the affairs of the trust.

62 Above n 46.

state of mind of the trustee. However the test is an objective one.[63] (Of course evidence of actual recklessness would not be likely to escape court censure). That is to say, the court compares the action alleged to have been imprudent with what might have been expected of the hypothetical prudent person.

The objective nature of the test has two important practical effects. First, it establishes a benchmark for performance that, in theory, can be applied consistently. This is an important consideration for policy makers and regulators, as well as for trustees seeking to ensure that they comply. As we shall see, though, the fact that trust law takes contemporary technology (in the form of know-how and practices) as its benchmark for prudence ensures that the substantive effect of the rule retains contemporary relevance. Second, it relieves the plaintiff of the evidentiary burden of establishing that the trustee had, in fact, a careless attitude. This somewhat assists beneficiaries overcome the difficulty they face securing trust information to ascertain whether they may have a claim against the trustee.[64]

In each of the cases described above, the trustee's exercise of the investment power was characterised as imprudent. Importantly, this does not mean that the type of investment was necessarily a problem for the trust in question. In theory, at least, the trustee might have been able to make those types of investments but for the deficiencies in diligence and/or care identified by the courts.[65]

Prudence as risk-aversion and the avoidance of speculation

The second line of cases focuses on the nature of the investment itself. The cases typically arise where the trustee has purchased an investment outside those expressly nominated in the trust instrument and the beneficiaries are seeking

63 *Learoyd v Whiteley* (1887) 12 App Cas 727.

64 See Chapter 8 below.

65 The want of diligence central to many of these cases links them to certain other investment-related cases, such as those directed at a trustee's failure to pursue with adequate vigour the 'getting in' of trust assets (eg *Styles v Guy* (1849) 1 Mac & G 422; 41 ER 1328) or to invest in a timely manner (eg. *Byrchall v Bradford* (1821) 6 Madd 13; 56 ER 993; *Attorney General v Alford* [1855] 4 DeG M & G 843; 43 ER 737.

redress for a loss thereby incurred.[66] In these situations the court has to assess whether an investment (or investments) is appropriate (or "proper") for the trust. In other circumstances the court may be concerned that the choice of a certain investment strategy may unduly favour one class of beneficiary over another.[67] This is clearly an important issue in a family trust where, for instance, a heavily income-oriented investment strategy might unduly favour the interests of the income beneficiaries at the expense of the capital beneficiaries.[68] It is less often an issue for superannuation funds, though in theory it intersects with whether the investment strategy designed for the default option of a fund is appropriate for members, an issue discussed in Part 5.4 below.

The cases most relevant to the current context are therefore those where the question was whether the investment was (or would be) too risky for the circumstances of the trust.[69] An example of this is *Adye v Feuilleteau*[70] where the practice of lending trust money on personal security was described as 'a species of gambling'. However that is not always the case. The courts have on occasion also had to consider claims that the investment strategy was too conservative, as famously occurred in *Nestle v Westminster*.[71] There are also cases in which the court

66 See for instance *Re Rider's Will Trusts* [1958] 3 All ER 135; *Chapman v Browne* [1902] Ch 785; *Crook v Smart* (1873) 11 SCR (NSW) Eq 121; *Knott v Cottee* [1852] 16 Beav 77; 51 ER 705.

67 See for instance *Raby v Ridhalgh* (1855) 7 De M & G 104; 44 ER 41. Also Chantal Stebbings, *The Private Trustee in Victorian England* (CUP, 2002).

68 *Crook v Smart*, above n 66. For a recent example, see *Murdoch v Commissioner of Taxation* [2008] FCAFC 86.

69 *Mant v Leith* (1852) 15 Beav 524; 51 ER 641. Also *ASIC v Parker* above n 54 (in respect of the Claireview investment).

70 (1783) 1 Cox. 24, at 25; 29 ER 1045, at 1046 per Lord Commissioner Hotham.

71 *Nestle v National Westminster Bank* [1993] 1 WLR 1260. Not so famously, this possibility was also alluded to by Finn and Zeigler:

> The time may not be far away when some trustees may be challenged to justify their [overly] conservative strategies. Conservatism may make life easier for trustees, but not necessarily for beneficiaries

Above n 51,337.

was asked to empower the trustee to invest beyond the set of investments authorized by the trust instrument,[72] or to provide guidance on whether specific types of investments (usually common stock) fell within the ambit of the express terms of the trust.[73]

Today the trust instruments of most superannuation funds are widely permissive in respect of investment. The government has repeatedly declined to impose limits on the investments that trustees may make, preferring to leave that to the decision of the trustee.[74] The problem is typically therefore not whether the trustee has authority to invest in a particular asset, but whether an investment in such an asset is consistent with the circumstances of the trust and the interests of beneficiaries.

On what basis is such an assessment to be made? Or perhaps more specifically, what are the criteria by which appropriateness will be gauged? In *ASC v AS Nominees*, Finn J referred to the 'requirement of caution'[75] that has historically been important in trust law; a prioritization of preservation of capital over the pursuit of investment gain.[76] With respect that historical preference is far less relevant in the superannuation context, and indeed is contrary to the intense focus that trust law has on ensuring the trustee has regard for the interests of the beneficiaries. Caution of the type apparently envisaged by Finn J in respect of investment risk may be relevant for trusts in certain circumstances, but it would be clearly inappropriate in the superannuation context where, as Megarry V-C pointed out in *Cowan v Scargill*[77] the interests of the beneficiaries are identified with the accumulation of financial benefits.

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72 As in *Re Strang* (1941) 41 SR (NSW) 114; *Riddle v Riddle* (1952) 85 CLR 202; *Re Baker* (1961) VR 641 and *Will and Estate of William Lionel Buckland dec'd; ANZ Executors and Trustee Co Ltd v A-G for Victoria* (Unreported, Supreme Court of Victoria, Nathan J, 11 August 1993).

73 As in *Re Harari's Settlement Trusts* [1949] 1 All ER 430; *Bethell v Abraham* (1873) LR17 Eq 24; *Re Walker* (1903) 3 SR (NSW) 163.

74 See for instance Dawkins, *Strengthening Super Security* (1992), 3.

75 Above n 46, 12.

76 See also *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438, 494.

77 [1985] 1 Ch 270. See further in Part 5.4 below.

Section 52(2)(f) of the *SIS Act* is relevant in this regard. It implies into the governing rules of all superannuation funds a covenant by the trustee that it will:

> 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 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

The covenant thus provides a set of criteria by which the appropriateness of any specific investment should be judged. In effect, Section 52(2)(f) of the *SIS Act* conditions the operation of trust law in respect of this aspect of 'prudence.' Importantly, though, s 52(2)(f) is neither proscriptive nor particularly prescriptive. The requirement to have 'regard' for the whole of the circumstances leaves open the possibility that other considerations may legitimately prevail in a particular case. Also the covenant clearly anticipates that other criteria may be relevant; the list of criteria is expressly inclusive and is not intended to be limiting. Even the criteria themselves are not very specific; risk, return, diversification, liquidity and relation to the liabilities are criteria that would be present in any modern investment approach.[78] As such it reduces the risk of obsolescence and does not force trustees to employ any particular investment strategy.[79]

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78 For a more detailed discussion of the relation between this provision and the state of modern investment thinking, see Donald, above n 52, 53-58.

79 This is contrary to some commentators who misinterpret the reference to risk, return and diversification as a requirement to employ Modern Portfolio Theory. See for instance W.A. Lee, 'Trustee Investing: Homes and Hedges' (2001) 1 *Queensland University of Technology Law and Justice Journal* 3 and B J Richardson, 'Do the

Equally, though, there are no precise standards set with respect to how much risk, what types of risk, and so on. The courts will therefore still have to form an assessment without the benefit of precise rules or heuristics. That is a prospect that might worry those critical of the court's ability to recognize contemporary investment 'best' practice. However, as we shall see, such concerns reflect a superficial understanding of the way such matters come before the courts, and in particular the use of expert witnesses.

The influence of contemporary expectations and understanding

Trust law has frequently been criticized for being unduly conservative in recognizing evolving standards with respect to the proper way to invest.[80] Even the courts have on occasion railed against the conservatism. For instance Phillips LJ in *Singer v Williams* described the evolution thus:

> It must be remembered that the Court of Chancery started with the view that there was only one investment open to trustees Consolidated Bank Annuities, that even investments in other Government stocks... were only gradually and somewhat grudgingly admitted, and that thenceforward, as from time to time the areas of trustees' investments has been extended, either by private investment or by Act of Parliament, the Court has always looked on each new investment as having the duty of making good its title to admission [to the list].[81]

The 'court lists' of authorized investments have been particularly maligned in this regard. Initially a set of guidelines for the appropriate investment of Chancery funds, they acquired a quasi-legislative aura, in effect becoming a reference list of investments that might be made by trustees in the absence of specific provisions in

Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?' (2007) 22 *Banking and Finance Law Review* 145. In fact those terms are characteristic of almost all investment theories, at least back to the mid nineteenth century – what changes is the way that financially-literate people interpret those terms.

80 See references at n 51 above.

81 [1921] 1 AC 41, 62.

the trust instruments.[82] This, in turn, inspired a succession of legislators to attempt to address through statute the Court lists' perceived inadequacies. In retrospect, of course, these statutory interventions shared the *hamartia* of the court lists, ossifying the standard around prevailing investment prejudices and stymieing the ongoing evolution of trust investment practices. The lists and statutes did this directly, through references in trust instruments to 'authorized' investments. They had an effect indirectly also, when the court read down even explicitly broad investment powers to fall within only those investments recognized in the court or statutory lists.[83]

The influence of the court lists has now been consigned to history. The older, more prescriptive statutory provisions have largely been replaced by provisions of a more 'open textured' nature[84] such as s 52(2)(f) of the *SIS Act* and the relevant sections of the trustee legislation in each State.[85]

This has in turn freed the courts to accept into evidence expert testimony on the state of contemporary investment theory. One of the strengths of this approach is that, in theory at least, the standards will be re-calibrated continuously to reflect contemporary investment thinking.

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82 For a discussion of the genesis and context of the lists, see Stebbings, above n 67, 131.

83 See for instance *Re Braithwaite* [1881] 21 Ch D 121; *Crook v Smart*, above n 66; *Bridges v Shepherd* (1921) 21 SR (NSW) 220. This circumscription was considered inappropriate by the middle of the following century; *Re Harari's Settlement Trusts,* above n 73.

84 Longstreth, above n 51, 12.

85 In NSW the *Trustee Amendment (Discretionary Investments) Act 1997* amended s14 of the *Trustee Act 1925* (NSW) to permit a trustee, unless expressly forbidden by the instrument creating the trust, to invest trust funds in any form of investment. This wide discretion is subject to a set of considerations for which the trustee must have regard; *Trustee Act,* s14C, and the broader requirement to act impartially and in the best interests of present and future beneficiaries; *Trustee Act,* s14B(2). It is also subject to a duty to avoid investments that are 'speculative' or 'hazardous', neither of which terms is defined in the Act; *Trustee Act,* s14B(2).

Of course, increased reliance on the testimony of experts creates its own issues. The image of an expert as an objective, neutral, impartial and reliable authority is described by Edmond and Mercer as 'simplistic'.[86] They note:

> Expertise is not mono-dimensional. Expert knowledge, authority and opinions are regularly contested, and contested in ways which are sensitive to the standing and credibility of individuals, the organisation of the discipline, field or profession, the particular (institutional) context, and pervasive public registers of science and expertise.[87]

Judicial officers are also reportedly concerned about how best to use expert evidence, though their concerns appear to have a slightly different origin. In 1998 Freckelton et al[88] found widespread judicial concern about the potential for bias in expert evidence and the difficulty of understanding highly technical material and in identifying the basis for expert opinions.

Trust law has not been immune to such issues. It is interesting to compare, for example, the references to expert testimony in the judgments delivered in *Re Baker*,[89] where the testimony of Messrs Baillieu, Carah, Merry and Larritt was apparently accorded some deference, to the genuinely adversarial, almost gladiatorial, use of experts apparent from the judgments delivered in *Nestle v Westminster*.[90] In the latter case the presiding Judge, Justice Hoffman at first instance, effectively had to judge the relative cogency of the experts, a task few judicial officers would relish if the matter became highly technical. Unfortunately the complexity of some of the investment practices of modern superannuation funds

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86 Gary Edmond and David Mercer, 'Experts and Expertise in Legal and Regulatory Settings', in Gary Edmond, (ed) *Expertise in Regulation and Law*, (Ashgate, 2004), 2.

87 Ibid, 3.

88 Ian Freckelton, Prasuna Reddy and Hugh Selby, *Australian Judicial Perspectives on Expert Evidence: An Empirical Study*, (Australian Institute of Judicial Administration, 1999).

89 Above n 72.

90 Above n 71, 1274, 1280.

means that the prospect of courts in the (near?) future being required to engage with highly technical material is more than a mere possibility; it is a near certainty.[91]

Of course, the court's decision in *Re Kolb's Settlement*,[92] is a salient reminder that the court will not accept uncritically modern investment technology. In that case, the absence of an unambiguous expert consensus on what the terms 'blue chip' and 'first class' connoted precisely (the general sense was clear) inspired the court to strike down as void the relevant investment power.

Overall, though, the open-mindedness implicit in the approach taken by trust law (at least since the demise of the court lists) is important because the proliferation of new and innovative investment practices within superannuation fund portfolios shows little sign of abating. As the discussion below relating to so-called 'alternative' investments illustrates, markets will continue to challenge 'the adaptable wit'[93] of both the prudent man and the regulatory scheme designed to enforce it. Trust law's connection to contemporary thinking through the medium of the prudent person, is a suitable complement to s 52(2)(f)'s open-textured approach. Together they ensure that the substance of the regulatory scheme, in this respect at least, keeps pace with developments in investment technology.

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91 The examination of unit-pricing and subscriptions and redemption minutiae required in *Basis Capital Funds Management v BT Portfolio Services* [2008] NSWSC 766 is a recent illustration of this. An earlier case in which the court felt more confident in its ability to assess the state of contemporary investment practice is *Will and Estate of William Lionel Buckland dec'd,* above n 72.

92 [1962] Ch 531.

93 The phrase is borrowed from Longstreth, above n 51.

The Prudent 'Person'

The second element of the covenant deserving attention is the reference to the hypothetical prudent 'person.' This reference sounds innocuous but it was both unexpected and important. It continues to be important today because it sets the benchmark at a level quite different than might have been expected had the general law position been replicated in the covenant. That in turn sends important signals about the role that Parliament intended for trustees of superannuation funds.

In the lead up to the *SIS Act*, it was expected that Parliament would codify the existing trust law standard for the care and skill required of a trustee. In Australia that standard is usually expressed as that of the 'prudent business person', as articulated in *re Speight; Speight v Gaunt* by Jessel MR[94] In its stead, in s 52(2)(b) Parliament chose the less exacting, and differently nuanced, 'ordinary prudent person'. To further complicate matters, the Treasurer of the day, in describing the proposed provision, expressed an intention to follow the lead set in the US by the *Employee Retirement Income Security Act of 1974* ('ERISA,')[95] which would have introduced the 'prudent expert' rule[96] to Australia. In addition to these prudent folk, the literature from time to time makes reference to the 'prudent investor'[97] and the 'prudent trustee'.[98] Why, then, did Parliament choose the 'ordinary prudent person' over the prevailing trust law standard and the other, potentially credible alternatives?

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94 *Re Speight; Speight v Gaunt* (1883) 22 Ch 727; *Breen v Williams* (1996) 186 CLR 71, 137 (Gummow J).

95 Dawkins, *Strengthening Super Security* (1992), 10.

96 Longstreth, above n 51; *Institutional Investment in the United Kingdom: A Review*, (HMSO, 2001), (the 'Myners Report'), 45.

97 See for instance American Law Institute, *Restatement (Third) of Trusts* (1992), §227 and the *Uniform Prudent Investor Act* in the US.

98 This is typically a US phenomenon. See for instance the influential Austin Scott, *Scott on Trusts* (3rd edn, 1967), 1806. But Cf Mayo Shattuck, 'The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century', 12 *Ohio St Law Journal* 491.

One possible answer is that Parliament simply followed the direction provided by the Law Reform Commission report of the previous year.[99] In that report, the Commission cited *re Whiteley; Whiteley v Learoyd* [100] as the authority for the proposition that

> The level of skill to be exercised by a trustee has been held to be that which a person of ordinary prudence would exercise in dealing with the property of another person for whom he or she felt morally bound to provide[101]

Closer attention to the judgments delivered by the members of the Court of Appeal in that case would have identified that two, Lindley LJ and Lopes LJ, specifically used the 'prudent business person' formulation.[102] Only Cotton LJ opted for the 'ordinary prudent person' standard [103] reported by the Law Reform Commission.

However the choice of the 'ordinary prudent person' standard may not have been as inadvertent as that explanation implies. It has been suggested that the reference to an 'ordinary prudent person' was intended to set the standard of care low enough to accommodate the influx of member-elected trustees required by the equal-member-representation requirements of the *SIS Act*.[104] That is possible, but of course, as Chapter 4 demonstrated, regulating the care, skill and diligence of trustees has only an indirect influence on the care, skill and diligence required of individual directors of the trustee company. The individuals' conduct is subject to the *Corporations Act*

99 Law Reform Commission, *Superannuation* (1992).

100 (1886) 33 ChD 347.

101 Law Reform Commission, *Superannuation* (1992), 9.23.

102 Above n 100, 355 (Lindley LJ); 358 (Lopes LJ).

103 Ibid, 350.

104 Donald Duval, Australian Government Actuary, 'The Objectives of the Superannuation Supervisory Legislation ', presentation to Law Council of Australia Superannuation Conference (1994), [1.8]; Lisa Butler, 'The super standard of care – How high should superannuation trustees jump' (2008) 2(3) *Journal of Equity* 225, 236. In fact, as Paatsch and Smith pointed out at the time, many of the 'employee' representatives were likely to be union officials, who might be presumed to have a level of expertise different from that of the lay rank and file member; Dean Paatsch and Graham Smith, 'The regulation of Australian superannuation: an industrial relations perspective. Part 2'(1992) 6(1) *Corporate and Business Law Journal* 29, 54.

in the first instance, and only regulated tangentially in the *SIS Act*, via s 52(8). Perhaps that nuance escaped policy-makers at the time.

Whatever the reason for the specific form the provision finally took, the choice of words is significant today. The reference to an 'ordinary prudent person' sends clear signals about what is expected from trustees in the governance of superannuation funds. One way to highlight this is to speculate about other choices that might have been made.

The prudent 'investor'

Consider for a moment the consequence had Parliament chosen to employ the phrase 'prudent investor' rather than the 'prudent person'. Emphasizing the trustees' investment duties in this way might have suggested that s 52(2)(b) was intended to apply uniquely to the investment decisions of the trustee, and not to the broader range of activities involved in administering a superannuation fund, such as maintaining member accounts, payment of contributions and other taxes, communicating with members, assessment of disability claims and reporting to relevant regulators.

Reference to a prudent 'investor' might also have sent a signal that the trustees were expected to engage directly and actively in the detail of the investment decision-making. In fact, as Chapter 1 outlined, the *SIS Act* explicitly recognizes that trustees may appoint investment specialists to assist in activities relevant to the administration of the trust. Rather, the *SIS Act* conceives of the trustee as at the centre of the web of bilateral and multi-lateral relationships covering all aspects of the administration of the trust; the virtual institution described in Chapter 1.

The prudent 'expert'

What about the so-called 'prudent expert'? Reference to a 'prudent expert' would have suggested a requirement for specialized expertise which would contrast traditional notions of trusteeship, as articulated in the cases cited above.

It is hard to argue with the proposition that trusteeship of a modern superannuation fund requires specialist expertise.[105] Specialized expertise is a vital ingredient in many aspects of the operation of a superannuation fund, from investment to taxation and operations. It is also hard to argue that trustees of superannuation funds ought not be measured against an exacting standard of care, skill and diligence given the magnitude of the assets under their care and the importance of superannuation balances to most retirees.[106]

However the risk in specifying a 'prudent expert' standard is that it would be understood to require such expertise on the part of the trustee itself. It is not obvious that all of the expertise necessarily has to be provided by the corporate trustee itself. It seems more plausible in the modern superannuation fund environment that trustees need to be able to harness the skills, energies and expertise of a wide range of specialists.[107] That is a task which implies some level of expertise but not necessarily technical omnipotence.

There might even be some disadvantages of an 'expert' board. Expertise carries with it a set of biases that are systematic but often go unnoticed. The biases arise because experts are likely to have common experiences, training and aptitudes. As a result they are likely to approach problems from a similar perspective and with a similar set of tools and data. In contrast, the benefits of a diverse board noted in Chapter 4 rely on a diversity of information sets and analytical methods being brought to bear on each decision. The 'common' sense provided by thoughtful and attentive lay people acting on a board may therefore be a very effective antidote to

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105 Gordon Clark and Roger Unwin, 'Best-practice pension fund governance' (2008) 9 *Journal of Asset Management* 2.

106 *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36, [33 - 34].

107 There is some evidence that this is precisely how trustees in Australia see their role: Vrinda Gupta, Henry Jin, Michael Orszag and John Piggott, 'How do Australian Superannuation Trustees Perceive Their Role and Effectiveness', in John Evans, Michael Orszag and John Piggott (eds), *Pension Fund Governance. A Global Perspective on Financial Regulation* (Edward Elgar, 2008).

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over-reliance on the received wisdom emanating from the expert-laden superannuation environment. Thus while expertise is an essential ingredient in a well managed superannuation fund, legislating for it as a standard against which the trustee is to be measured may prove dysfunctional.

The prudent 'business person'

What about the 'prudent business person' of *Speight v Gaunt*?[108] Setting aside the possibility that the reference to a 'business person' might have had unacceptable political overtones in the industrial relations environment of 1993, it seems reasonable to observe that reference to a 'prudent business person' might have implied that Parliament was prepared to accept a more entrepreneurial attitude to risk-taking by trustees. Such a proposition might not seem outlandish today, but in 1993 Parliament's emphasis was on prudential safeguards and the security of the newly-mandated Superannuation Guarantee monies. In that context, the conservative, paternalistic language surrounding trusteeship was an important ingredient in the rhetoric designed to inspire confidence in the new regulatory scheme.[109]

The prudent 'trustee'

Finally, reference is sometimes made to a prudent 'trustee'.[110] Although the adjective 'prudent' in this formulation could be thought redundant, there is an element of the s 52(2)(b) covenant that suggests that this would be a mistake in the superannuation context. The addition of the gloss that the trustee should approach its task as if:

> dealing with property of another for whom the person felt morally bound to provide

infuses the requirement with a distinctly paternalistic tenor. We should be careful not to read too much into this element of the covenant, however. There is for instance no indication of precisely what moral impulse should inspire the trustee.

108 Above n 94.

109 See for instance Law Reform Commission, *Superannuation* (1992), [9.9].

110 See above n 98.

The reference seems intended to evoke the traditional, family trust context without specifically establishing any distinct requirements on the trustee.

At the very least, the reference to morality is somewhat incongruous in a commercial setting. And perhaps that incongruity is the point. It may be intended as a further signal that Parliament desired trustees of superannuation funds to go beyond the limited trustee role seen in many commercial trust contexts in pursuit of the interests of members. If that is the case, then perhaps a less oblique means of conveying that expectation should have been found.

An important caveat

As easy as it is to distinguish the different forms the provision might have taken, it is important not to overstate the differences. The actual difference between the alternative standards is not as great as it might appear. The courts have always looked to the context in which the trustee found itself to identify the relevant standard of care.[111] So for instance in attempting to identify the standard of care appropriate in the case confronting him in *Re Speight*, Jessel MR, at first instance, asked himself the question 'what are the usual precautions taken by men of business when they make an investment?'.[112] Similarly, Lindley LJ in *Re Whiteley* noted:

> care must be taken not to lose sight of the fact that the business of the trustee, and the business which the ordinary prudent man is supposed to be conducting for himself, is the business of investing money for the benefit of persons who are to enjoy it at some future time[113]

He goes on to provide the *locus classicus* of the prudent person standard, on which s 52(2)(b) is based:

> … the duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary

111 For the sake of completeness, it is worth noting that the courts take the same stance with respect to company directors; *Gould v Mount Oxide Mines (in liq)* (1916) 22 CLR 490, 531, per Isaacs and Rich JJ.

112 Above n94.

113 (1886) 33 ChD 347, 355.

> prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.[114]

So it would be misleading to draw too great a distinction between the prudent 'person' and the prudent 'trustee'.

The confluence of standards is also evident in the so-called 'prudent expert rule' in *ERISA*. The relevant provision makes no reference to an 'expert' at all. In fact it requires a fiduciary to act:

> with the care, skill, prudence and diligence *under the circumstances then prevailing* that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. [115] (emphasis added)

Again, then, the wording in the *ERISA* provision invokes directly the context in which the trustee is acting, though in this case (unlike s 52(2)(b)) there is explicit reference to a level of expertise.

The professional trustee

There is one last complication to address. Trust law was traditionally wary of permitting trustees to be compensated for their efforts lest the presence of a pecuniary interest should compromise their administration of the trust.[116]

Nevertheless, the trustees of most large superannuation funds today are remunerated for their services. [117] This includes even those that claim to operate on a 'not-for-profit' basis. The professionalism of trustees is important in the context of

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114 Ibid, 355.

115 *ERISA* §404(a)(1).

116 *Robinson v Pett* (1734) 3 P. Wms. 249; 24 ER 1049. That said, in recent decades the court has invoked its inherent jurisdiction to authorise trustee remuneration where the deed is silent, in those circumstances where it thinks it necessary for the proper administration of the trust; *In re Duke of Norfolk's Settlement Trusts* [1982] Ch 61; *Re Sutherland* [2004] NSWSC 798. In the superannuation context, see *Re Queensland Coal and Oil Shale Mining Industry (Superannuation) Ltd*, [1999] 2 Qd R 524.

117 *Re Queensland Coal and Oil Shale Mining Industry (Superannuation) Ltd*, above n 116.

the standard of care because where a commercial relationship was clearly envisaged, the courts have been prepared to apply a more onerous standard than that which would have otherwise applied. [118] Both *ASC v AS Nominees*[119] and *Wilkinson v Feldworth*[120] are authority for the proposition that this familiar trust law principle applies to the trustees of superannuation funds. Notably the trustee was, in both those cases, found to be grossly negligent (and hence most likely deficient in care under even the least exacting of standards) but there is no reason to suppose that a different result would have issued even if the conduct observed in either case had been better than the standard expected of an amateur trustee but below that expected of a professional. Here again, then, trust law's attention to context matters, and this pre-occupation can be expected to flow through to, and be consequential in, the regulatory scheme as a result of s 52(2)(b).

Diligence

Finally the reference in s 52 (2) (b) to diligence deserves to be considered. It is perhaps not taking too great a liberty to describe diligence as the junior member of the 'care, skill and diligence' triptych. It has attracted less attention both in the court and by commentators than either the standard of care or the requirement to act with skill. Yet skill without diligence would avail of little.

Trust law traditionally required greater diligence from trustees than company law required of its sibling fiduciary, the company director. As Stebbing notes, the responsibilities of the trustee in Victorian England were notoriously onerous and 'diligence' in that context was a heavy burden indeed.[121] In contrast, company law relied on the oft-quoted dicta of Romer J in *Re City Equitable Fire Insurance Co Ltd* [122] to the effect that a director

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[118] *Bartlett v Barclays Bank* [1980] 1 All ER 139.

[119] Above n46, 518.

[120] (1998) 29 ACSR 642.

[121] Above n 67.

[122] [1925] Ch 407.

> is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend to all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so.[123]

Such untaxing standards of diligence were possible because directors act collegially as a board and with the assistance of internal company management.[124] However trustees are required to act personally, which in the nineteenth century was interpreted to preclude delegation of all but the most ministerial of tasks.[125] In an environment where most private trusts were administered by three or fewer trustees, this placed a heavy burden on the individuals named as trustee.

Paradoxically, this is an area where the interposition of a corporation as trustee may have a positive practical substantive effect on the regulatory scheme. It is certainly true that applying notions of diligence to a corporation seems incongruous. However the diligence of the human actors animating the corporate trustee are today arguably adequately regulated by the *Corporations Act*, if the issue of members not having standing to enforce the duty[126] is ignored. Section 180 of the *Corporations Act* requires directors to be diligent in the exercise of their powers and discharge of their duties. Moreover, modern company law has raised the standard of diligence in the years since 1925. Attendance at meetings is now required of directors unless there are 'exceptional circumstances'[127] and directors are required

123 *Re City Equitable Fire Insurance Company, Ltd* [1925] 1 Ch 407, 429.

124 Even more relaxed standards are apparent in, for instance, *In re Cardiff Savings Bank. Marquis of Bute's case* [1892] 2 Ch 100, in which attendance at just one meeting over eighteen years (the period between attaining majority and the bank's failure at the hands of a fraudulent officer) by the president of a bank was held not to be neglect or omission of his duty to exercise 'fair and reasonable diligence', 108.

125 *Ex parte Belchier* (1754) Amb 218; 27 ER 144; *Speight v Gaunt*, above n 94.

126 See Chapter 4 above.

127 *Vrisakis v ASC* (1993) 11 ACSR 162, 170 (Malcolm CJ).

to take ‘reasonable steps to place themselves in a position to guide and monitor the management of the company.’[128]

The directors of superannuation fund trustees appear to be taking this requirement for diligence seriously. According to research conducted by APRA in 2007,[129] trustee boards met, on average approximately 8 times per year, committing approximately 3.5 hours to each meeting. In addition, board members spent an average of nearly 100 hours on fund business outside board meetings each year per year.[130] It is notable however that a great deal of this time was spent overseeing continued compliance with regulatory requirements and with reviewing recent fund performance.[131] Rather less was spent on determining and implementing the fund’s asset allocation, communicating with members and selecting the fund’s advisers, investment managers and administrators, all of which might ordinarily be seen as at the core of the trustee’s role in a superannuation fund. Although there is no benchmark against which to assess objectively whether this commitment of time is sufficient,[132] or allocated appropriately across the various subject areas for board attention, 120-130 hours per annum is nonetheless a significant commitment of time and attention on the part of the individuals involved.

Concluding Comments on s 52 (2)(b)

The requirement under s 52(2)(b) attempts to secure for beneficiaries the benefit of the trustee’s attention and expertise. The fact that the provision does not match the general law position precisely is important but does not inspire any great difficulty. Parliament, in setting the benchmark at the level of the ‘ordinary prudent person’

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128 *Daniels t/as Deloitte Haskins & Sells v AWA Ltd*, n 76, 501.

129 APRA, ‘Superannuation fund governance: Trustee policies and practices’ (2008) *Insight*.

130 There was some variation in both meeting frequency and length in different sectors of the industry (corporate, industry, public sector and retail) but the overall magnitude was remarkably consistent across this dimension. Ibid, Table 4.

131 Ibid, Table 7.

132 Indeed, perversely, more hours spent in boardroom deliberation may in some cases actually be an indicator of frequent and/or large problems to be resolved.

rather than the 'prudent business person', has signaled the importance of lay participation in the governance of superannuation funds. In any case, where individual trustees are professional, or claim specialist expertise, a more intense standard can, and is likely to, be applied.[133]

Equitable doctrine can however make an important contribution in respect of the notion of prudence. In lay discourse, prudence is closely synonymous with terms like 'risk-averse' and 'cautious', and antonymous with terms like 'speculative' and 'reckless'. However the method by which trust law assesses 'prudence' gives it the ability to accommodate the insights from modern finance theory into the calibration of the standard required of trustees. The s 52(2)(b) covenant can benefit from this modality.

It also seems likely that the requirement that the trustee act as for someone 'for whom the person felt morally bound to provide' is evidence that Parliament intended to infuse into superannuation fund governance the paternalism inherent in traditional notions of trusteeship. It is a further reminder, along that the entity responsible for administering the trust is then, as Chapter 2 noted, distinctively a 'trustee' with the substantive consequences that implies.

Practical Examples

The general law and the *SIS Act* provide important signposts for trustees in the exercise of their investment power. This section highlights two of the issues inspired by the investment practices of Australian superannuation funds that relate to the duty of care imposed by the covenant in s 52(2)(b). The examples are intended to be illustrative and certainly do not exhaust the list of complexities and challenges.

133 *Barclays Bank v Bartlett*, above n 118.

Alternative investments and "due diligence" risk

Australian superannuation fund trustees have demonstrated an appetite over the past decade for what are sometimes euphemistically called 'alternative' investment strategies and instruments.[134] Examples include unlisted property, private equity, infrastructure, hedge funds, 'portable alpha' strategies, 'overlay' products, CDOs, performance swaps and structured products. In a recent survey APRA estimated that large funds on average allocated approximately 15% of their portfolios to such investments.[135]

The new types of investment pose a variety of new challenges for trustees. The approach taken by trust law that was described above enables us to organize those enquiries. It enables us to distinguish between two key questions. First, whether such investments promote achievement of the investment objectives set by the trustee, ie are they 'suitable' for the fund from an investment perspective.[136] Second, whether the legal structures and operational procedures associated with the new types of investment are such that a trustee, acting prudently, could make such an investment.

The first question need not detain us long here.[137] It is essentially a question of fact whether a particular investment will contribute positively to the structure of the

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[134] James Cummings and Katrina Ellis, 'Risk and Return of illiquid investments: A trade-off for superannuation funds offering transferable accounts' (Working Paper, APRA, November 2011).

[135] Ibid.

[136] The securities law notion of 'suitability' which requires an adviser to match the needs and circumstances of his or her client with the features and nature of the investment he or she is recommending to that client; see for instance *Henderson v Amadio* (1995) 62 FCR 1, 147, and more generally Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (Butterworths, 6th ed, 2003), 1322; Lewis Lowenfels and Alan Bromberg, 'Suitability in Securities Transactions' (1999) 54 *Business Lawyer* 1557; M Lipton, 'The Customer Suitability Doctrine', *Fourth Annual Institute on Securities Regulation*, 1973, 273.

[137] A more detailed analysis of this question is presented in Scott Donald, 'Prudence under Pressure' (2010) 4 *Journal of Equity* 44.

fund's investment portfolio in an *ex ante* sense. The trustee's assessment must be guided by the criteria articulated in the covenant in s 52(2)(f) and it should result from a process which demonstrates that the trustee was diligent in giving properly informed consideration to the decision. Even then, as *Nestle v National Westminster Bank*[138] makes clear, the courts will be slow to impugn the investment decisions of a trustee. The existence of strategies that could, with the benefit of hindsight, have delivered a superior outcome will not be sufficient.

The second question, whether a trustee acting prudently ought to make the type of investment under consideration, has arguably been under-estimated until very recently by market participants. Demonstrating that 'due diligence'[139] has been exercised when the legal structure constituting the investment is new, unusual or resident in another jurisdiction is not trivial.[140] Moreover, failure to attend to these issues exposes the fund to risks that finance theory suggests will not, on average, be compensated.[141] Trustees must therefore ensure that these 'due diligence' risks are eliminated, or at least substantially mitigated, prior to investment. To do otherwise exposes the fund to uncompensated risks and, consequentially, the trustee to an action for breach of its duty of care.

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138 Above n 71.

139 'Due diligence' is an industry term that describes the processes and analysis that are required prior to investment to ascertain and assess the crucial operational (as opposed to investment) details of the investment under consideration.

140 For a discussion of a sub-set of the peculiar legal risks relating to direct private equity investing, see Nuncio D'Angelo, 'Private equity investing by financial institutions: Navigating hidden reefs in treacherous waters' (2003) 31 *ABLR* 311. On hedge funds see Paul Ali, 'Adding Yield to Stable Portfolios: Regulating Investments in Australian Hedge Funds' (2001) 19 *Company and Securities Law Journal* 414, and on portable alpha see Paul Ali and Martin Gold, 'An Overview of "Portable Alpha" Strategies, with Practical Guidance for Fiduciaries and some Comments on the Prudent Investor Rule' (2001) 19 *Company and Securities Law Journal* 272.

141 Donald, above n 137. Also Stephen Brown, William Goetzmann, Bing Liang, and Christopher Schwarz, 'Trust and delegation' (2012) 103 *Journal of Financial Economics* 221.

There are three issues of particular pertinence to trustees considering 'alternative investments.'

1. Transparency

One of the largest 'due diligence' challenges facing a trustee is securing adequate transparency. It seems unarguable that a prudent person would certainly not purchase a 'pig in a poke,' to employ a quaint but entirely apt metaphor.[142] In some hedge fund or private equity vehicles this might prove a significant challenge.[143] Moreover, it is worth noting that lack of transparency is not merely a risk from an investment perspective. Opacity with respect to other unit-holders can also raise taxation, regulatory and anti-money laundering problems.

2. Valuation

Trustees investing in alternative asset types and strategies also have to face the issue of how to value the assets. The approach for listed assets, and those which trade at par, is well understood and practised. The same is true for some unlisted assets, such as many property and infrastructure assets, where there is a long-accepted practice of trustees employing independent valuers to appraise the current value of the asset.[144] Those processes become more difficult when trustees are attempting to value more complex assets, such as some structured products and certain collateralized debt obligations (CDOs). These are often traded over-the-counter and are not subject to truly independent valuation or market pricing. The models used to value the assets can be very complex, requiring high level legal, mathematical and financial skills, and, in many cases, 'proprietary' analytical tools. Failure to value the

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142 Though a trifle cute, this metaphor is irresistible here, referring as it does to the medieval confidence trick of substituting inferior meat (often a cat) in place of the advertised suckling pig. The unwary purchaser would get a nasty surprise when it came time to open the sack and inspect his or her purchase. It is also the source of the aphorism to 'let the cat out of the bag.' EC Brewer, *Dictionary of Phrase and Fable*. 1898.

143 Stephen Brown, Thomas Fraser and Bing Liang, 'Hedge Fund Due Diligence: A Source of Alpha in a Hedge Fund Portfolio Strategy' (2008) 6(4) *Journal of Investment Management* 23.

144 *Smith v Hassall* (1899) 22 LR (NSW) Eq 165.

investments accurately exposes the trust to the risk of member inequity (for instance when applications and redemptions are processed at incorrect valuations) or nasty surprises in the event of an unexpected default by the issuer of the underlying security or instrument. Direct investment by trustees into such investments thus raises the 'due diligence' bar very high indeed. Investment via intermediaries shifts the burden of conducting the calculations to the intermediary but nonetheless does not relieve the trustee of the responsibility for ensuring that the intermediary has the expertise and processes to deal with such assets.

3. Jurisdiction

Jurisdiction is an issue in alternative investing to a greater extent than other areas because of the customised nature of many of the legal structures employed. The court's instinctive nervousness about investments outside its jurisdiction[145] has perhaps faded with the globalization of finance, but issues of contractual interpretation and of enforcement remain important given that many of the new structures are established in jurisdictions perceived to have a light regulatory touch. This is especially true where the investment structures under consideration have a novel (and in some cases no) legal personality.

Risk cascades and interdependence

One of the practical challenges for trustees and advisers is that the two strands of prudence, whilst distinguishable in theory, may be interdependent. Take for instance a clause in the governing rules of an investment vehicle (such as a managed investment scheme) that permits the trustee of that vehicle to suspend redemption of units in certain market conditions. These terms are not uncommon and serve to preserve unit-holder equity in the event that volatile markets make the precise valuation of assets unreliable.

A narrow focus on that investment vehicle might conclude that such a term, implemented appropriately by the trustee, is an important safeguard. A halt in

[145] See for instance *Re Baker*, above n 72; *Re Walker*, above n 73. But cf *In the Will of Gibson* [1922] VLR 715.

redemptions of the investment vehicle might however place the superannuation fund investing in that vehicle in a difficult position if that possibility is not accommodated in its own processes and/or offering documents to members. Moreover, the fact that superannuation funds can borrow for a short term to meet redemption requests[146] means that the issue is not simply one of having cash available to meet the member's redemption because it might be unclear precisely what value to place on the units in the underlying investment. It may also be difficult to impose the costs of the borrowing to the outgoing (or switching) member. Finally, it may be inequitable to remaining members to redeem other, more liquid investments to meet the redemption as this leaves those remaining members even more exposed to the illiquid investment.

The problem thus arises not from the provision in the investment vehicle's governing rules but from the interplay between those rules, the rules of the superannuation fund itself and the market-based valuation protocols imposed by accounting standards. Though it is tempting to characterise such scenarios as 'worst case', it is worth recalling the words of Romer LJ that:

> a prudent investor ought to contemplate the possibility of [bad times] happening [147]

That is, prudence proves its value not when times are smooth, but when challenges arise. This suggests that due diligence processes need to encompass not just the risks endogenous to the investment or instrument under consideration, but also the exogenous risks that could affect it and the risks that arise from the interaction of different mechanisms and processes within the trust.

Are alternative assets simply imprudent per se?

The question inspired by this litany of issues is whether alternative assets are simply imprudent *per se*. Should the courts' former aversion to share investing, to foreign investment and to derivatives be adopted in respect of the types of assets currently labeled 'alternative', at least until regulation and market practice combine to address

146 *SIS Act,* s 67(2)(a).

147 *Chapman v Browne* above n 66.

some of the more obvious problems. The analysis presented in this Part suggests that such an approach is not only unnecessary, it is probably undesirable. It is worth recalling that all investments are attended with risk. Indeed history records a disconcertingly high frequency of default even in securities backed by sovereign issuers.[148] As Putnam J famously noted almost two centuries ago

> Do what you will, your capital is at hazard.[149]

Finance theory suggests a more nuanced attitude to risk might serve trustees well. Differentiating between those types of risks that, on average, are likely to be rewarded by the market, or else for which the investor has some reasonable expectation of earning an 'excess' return, and those for which no such reward is likely, generates a powerful decision rule for trustees that is entirely consistent with the approach now taken in trust law. It suggests that trustees should avoid all forms of investment, whether labeled 'alternative' or not, unless their due diligence processes of research, analysis and ongoing monitoring can substantially mitigate or eliminate the unrewarded risks. Then they need to assess carefully whether the net reward expected is sufficient to render the investment suitable for the unique needs and circumstances of the trust. That process of analysis may raise the hurdle to a level where few 'alternative' investment will pass, but that will be because of their investment credentials, not their novelty.

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148 Niall Ferguson, *The Cash Nexus. Money and Power in the Modern World 1700-2000*, (Basic Books, 2001), Ch5.

149 *Harvard College and Massachusetts General Hospital v Amory* 26 Mass (9 Pick) 446 (1830).

Peer Group Pressure

A second area in which contemporary practices encounter the notion of prudence arises from the anecdotal evidence of the role that peer group comparisons currently play in the decision-making of trustees.[150] Strict application of both the general law and the requirements under the *SIS Act* would suggest that trustees of superannuation funds must remain narrowly focused on the needs and circumstances of the trust for which they are responsible. However there are at least two sources of pressure on trustees to depart from this orthodoxy.

The first is the encouragement given to trustees to have regard for 'best practice' in Australia and abroad.[151] One prominent example of this in recent years was the trend, noted in the example above, for superannuation funds to make comparatively large allocations to 'alternative' investment such as private equity, hedge funds and forestry. The appetite for these assets followed reports of eye-catching return histories for some prominent funds. It is perhaps too late now to point out that the exemplars have been drawn, usually, from the United States, and often from foundations and endowments, such as those associated with Yale and Harvard.[152] The problem is that the circumstances and objectives of those funds were quite

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150 'Total fund focus needed with alternative investments' *Super Review*, 2 March 2005. More generally, Drew and Stanford identify the presence of peer group comparisons as an agency cost that impacts on performance: Michael Drew and Jon Stanford, 'Principal and Agent Problems in Superannuation Funds' (2003) 1 *Australian Economic Review* 98.

151 Industry organisations are particularly prone to such exhortation. See for instance material appearing on the websites of ASFA (www.superannuation.asn.au) and AIST (www.aist.asn.au). The press is also enrolled in the mantra; Simon Hoyle, 'It's survival of the fittest in race for gold,' *Sydney Morning Herald*, 9 February 2008, 48.

152 Indeed press reports indicate that these exemplars are themselves feeling under pressure in the current market environment. See for instance John Hechinger and Craig Karmin, 'Harvard Hit by Loss as Crisis Spreads to Colleges', *Wall Street Journal*, 4 Dec 2008, A1; John Hechinger, 'Crisis on Wall Street: Yale to Trim Budget as Its Endowment Falls 25%', *Wall Street Journal*, 17 Dec 2008, C3.

different from those of Australian superannuation funds.[153] In particular, the difference in liquidity requirements of defined benefit plans and endowments compared to the typical DC-oriented, public offer superannuation fund in Australia cannot be under-estimated. Anecdotal reports indicate that though there have been no public failures of large-scale superannuation funds as a result of liquidity problems, a number of funds have had internal cashflow management issues, including difficulties meeting the cashflows arising from maturing currency hedge strategies and members switching between investment options.[154] The challenge, then, for the regulatory scheme is to support and even encourage appropriate peer comparisons by trustees as a way to embed advances in technology into the system at a granular level, whilst discouraging unthinking emulative behavior that may lead trustees to disregard important differences in the context in which their decisions are taken.

The second source of pressure for comparison arises from the promotion of competition as a public policy objective. As was noted in Chapter 2, promotion of competition was a key element of the public policy reforms flowing from the Wallis Report. One manifestation of this policy is APRA's recent decision to publicize individual fund returns in order for consumers to make an 'informed choice.'[155] Note, though, that in contrast to the comparisons inspired by the desire to emulate 'best practice', the comparisons here are wider-ranging. Anecdotal evidence suggests that many funds regularly compare their past performance as well as their

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153 This is vividly illustrated in David Swenson, *Pioneering Portfolio Management: An Unconventional Approach to Institutional Investment* (Free Press, 2000) in which the author (a former executive responsible for the management of the Yale endowment) devotes the first two chapters at the outset describing the unique circumstances that facilitated and required those strategies.

154 See for instance, Tony Boyd, 'Strategy looking not so super,' *Australian Financial Review,* 9 July 2010, Chanticleer 60; Jonathan Barrett, 'Fund adapts to liquidity concerns,' *Australian Financial Review*, 2 February 2010, 52.

155 See www.apra.gov.au.

strategies to those of their peers (not just the 'best practice' exemplars) as a regular part of their decision process.[156]

This policy has had another perverse consequence relevant in the context under discussion here. It is easy to see that the trustees of most superannuation funds in Australia face asymmetric incentives to risk-taking. In most co-mingled investment contexts, stellar recent performance is the most powerful determinant of fund flows.[157] This means that 'investment fiduciaries'[158] often have an incentive to be risk-seeking. The distinction in the superannuation and pension fund context is that most cashflows into the superannuation system are mandated and flow to the default option in the default fund provided to the employee. In this context, a commercially-oriented superannuation fund trustee is much more powerfully influenced by the danger of disrupting that 'default' cashflow by materially underperforming its peers than it is by the potential to attract new funds by outperformance.[159] Thus competition in the Australian superannuation context has had the perverse (and almost certainly unanticipated) effect of reducing diversity,[160] innovation and risk-taking while simultaneously diverting trustees' attention from the unique needs of the members of their fund.

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156 See for instance Wouter Klijn, 'Aussie super funds focus too much on peers' *InvestorDaily*, 9 August 2010; available at www.investordaily.com.au.

157 The classic treatment is Richard A. Ippolito, 'Consumer reaction to measures of poor quality: Evidence from the mutual fund industry' (1992) *Journal of Law and Economics* 45. More recently, see Philip Gharghoria, Shifali Mudumbab, Madhu Veeraraghavan, 'How smart is money? An investigation into investor behaviour in the Australian managed fund industry' (2007) 15(5) *Pacific-Basin Finance Journal* 494.

158 The term is used by Gold and others to describe institutions, not all of them fiduciary in a strict sense, responsible for the investment of assets in trusts and similar vehicles; Martin Gold, *Fiduciary Finance. Investment Funds and the Crisis in Financial Markets*, (Edward Elgar, 2010).

159 David Blake, Bruce Lehmann and Alan Timmerman, 'Performance Clustering and Incentives in the UK Pension Fund Industry' (1998) 3 *Journal of Asset Management* 17.

160 Gerry Gallery, Natalie Gallery and Lyn McDougall, 'Don't Judge a Superannuation Default Investment Option by its Name (2010) 20 *Australian Accounting Review* 286.

The problem is that although aspiring to learn from best practice is laudable, regard must always be had for each trust's unique circumstances. It is hard (and from a policy perspective, probably inappropriate) to argue against the proposition that close attention to the needs of a fund's own members should prevail over the considerations of competitiveness and peer-risk management that lie behind much peer comparison. Nevertheless the influence of peer behaviour is strong and the asymmetric incentives faced by trustees can overwhelm the apparent substantive contribution of trust law in promoting careful attention to the needs of members.

5.4 The duty to act in the 'best interests' of beneficiaries

The second of the provisions of the *SIS Act* to be examined in this detail is s 52(2)(c). It inserts into the governing rules of each superannuation fund a covenant by the trustee to ensure that its:

> duties and powers are performed and exercised in the best interests of the beneficiaries

Section 52(2)(c) requires trustees to pursue the interests of their beneficiaries. As such, it plays an important role in defining what is expected of the trustee, both orientating the trustee towards the interests of members (and away from other competing or distracting influences) and, more controversially, catalysing the trustee in its administration of the trust.

The words employed in this provision evoke similar words famously used in the judgment of Megarry V-C in *Cowan v Scargill* that:

> [it is] the duty of trustees to exercise their powers in the *best interests* of the present and future beneficiaries of the trust [161] (emphasis added)

It might reasonably be expected therefore that interpretation of s 52(2)(c) might be informed by the jurisprudence surrounding Megarry V-C's formulation. The problem is that the general law 'duty' articulated by Megarry V-C has a shaky provenance. The phrase 'best interests' appears for the first time in trust law in *Cowan v Scargill*,[162] and the subsequent case law is equivocal about the content of the duty it purports to describe. Uncertainty must therefore also attach to the interpretation of s 52(2)(c).

This Part proceeds as follows. It first outlines the relevant statutory provision: s 52(2)(c) of the *SIS Act,* identifying the features of the provision that warrant closer analysis. Each of those features is then examined, with comparison to the general law where relevant. Finally, it describes two practical situations in which the best

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161 *Cowan v Scargill* [1985] 1 Ch 270, 287.

162 Scott Donald, '"Best" interests?' (2008) 2 *Journal of Equity* 245.

interests duty has application. These practical examples illustrate how the interpretation of s 52(2)(c) offered in this Thesis can provide practical guidance for trustees faced with real-world issues.

The main conclusion of this Part is that despite the uncertainty surrounding the provenance of the 'best interests' duty in trust law, the covenant itself is effective in imposing a requirement on trustees to orientate themselves towards the interests of fund members. It also requires trustees to focus on finding the optimal course of action, without holding them to account if, with the benefit of hindsight, an alternative course of action might have proved more profitable. That is, it is a standard that, like prudence, is applied *ex ante*, not *ex post*. As such it is a complement to the other requirements discussed in this Chapter, the requirement to act with the care, skill and diligence of a prudent person, imposed by s 52(2)(b) of the *SIS Act* the 'sole purpose' test in s 62 of the *SIS Act* (discussed in Part 5.5 below).

The Statutory Duty

Section 52 of the *SIS Act* provides:

> (1) If the governing rules of a superannuation entity do not contain covenants to the effect of the covenants set out in subsection (2), those governing rules are taken to contain covenants to that effect ...
>
> (2) The covenants referred to in subsection (1) are the following covenants by each trustee of the entity: ...
>
> > (c) to ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries;

Superficially, Section 52(2)(c) is not a complex provision. It is syntactically straightforward and uses terms the lay meanings of which would be familiar to most people. It would seem, to borrow a phrase from Mason J, to be

> reasonably clear in its expression to a mind uninhibited by a familiarity with the complexities of the common law.[163]

[163] *Sungravure v Middle Eastern Airways* (1975) 5 ALR 147, 163.

Nevertheless, there are a number of aspects of the provision that deserve attention here:

1. the existence in the general law of a distinct duty to act in the 'best interests' of beneficiaries is contested, creating uncertainties as to the precise content of the duty;
2. given those uncertainties, the use of the adjectival superlative 'best' in the provision cannot be ignored; and
3. the reference to the 'interests' of beneficiaries.

These observations provide a structure for the analysis that appears below.

Analysis of the Statutory Duty

The phrase 'best interests' is not defined in the *SIS Act*. Nor did Parliament attempt to characterise or otherwise amplify what it took to be the meaning of 'best interests' in other provisions. Regard must therefore be had for other sources to define the content of the duty articulated by s 52(2)(c).

In that light, it is hard to go past the presence of the phrase in the judgment of Megarry V-C in *Cowan v Scargill*,[164] perhaps the most famous superannuation (pensions) case in the Anglo-Australian arena. In that case, Megarry V-C held that:

> [it is] the duty of trustees to exercise their powers in the *best interests* of the present and future beneficiaries of the trust [165] (*emphasis added*)

This is the most likely source of the phrasing used in s 52(2)(c). The phrase and its attribution appear prominently in the Law Reform Commission report[166] that inspired and influenced the *SIS Act*.[167]

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164 Above n 161.

165 Ibid, 287.

166 Law Reform Commission, *Superannuation* (1992), [9.22].

167 The role of the Law Reform Commission's report in guiding the drafting of the *SIS Act* was discussed in Part 5.1.

It seems likely that Parliament believed it was adopting an accepted and unambiguous body of law when using the phrase 'best interests' in s 52(2)(c). Parliament would hardly employ a term it knew to be ambiguous or otherwise flawed. The problem is that Parliament's confidence (and that of the Law Reform Commission) was misplaced. There was in fact little jurisprudence available in 1993 to illuminate clearly the content of Megarry V-C's duty to act in the 'best interests' of beneficiaries. Indeed examination of the case law suggests that Megarry V-C was employing the phrase for the first time in trust law. Indeed one commentator has gone so far as to describe it as:

> unhistorical, simplistic, true in part only and misleading.[168]

This is not mere pedantry. The questionable provenance of the duty articulated in s 52(2)(c) causes significant problems. Bereft of precise definition, its application to difficult cases will be attended with uncertainty. It makes for an unsteady foundation on which to build what is, *prima facie*, a key duty imposed on superannuation trustees. This is illustrated by the practical examples presented below.

The provenance of the duty to act in the 'best interests' of the beneficiaries

There is consensus amongst commentators that the starting point for understanding s 52(2)(c) is the segment, quoted above, of Megarry V-C's judgment in *Cowan v Scargill*.[169] Despite attracting criticism from some commentators at the time,[170] Megarry V-C's judgment in *Cowan v Scargill* is widely quoted in both pensions cases and trust law commentaries. In a wide ranging discussion on trusteeship in the context of pensions funds, Megarry V-C generated influential statements on the

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168 S E K Hulme 'The Basic Duty of Trustees of Superannuation Trusts — Fair to One, Fair to All?' (2000) *Trust Law International* 130.

169 See for instance Margaret Stone, 'The Superannuation Trustee: Are Fiduciary Obligation and Standards Appropriate?' (2007) 1 *Journal of Equity* 167; Geraint Thomas, 'The duty of trustees to act in the 'best interests' of their beneficiaries' (2008) 2 *Journal of Equity* 177.

170 See for instance Julie Maxton and John Farrar, 'Social Investment and Pension Scheme Trusts' (1986) 106 *Law Quarterly Review* 32.

relevance of trust law to occupational pension schemes, the relevance of non-financial (eg ethical or moral) criteria to a trustee's exercise of its investment power and the application of the prudent man rule to trusteeship of pension trusts. Notably, though, the courts have been less inclined to adopt Megarry V-C's 'best interests' formulation than other parts of his judgment.

One reason for the courts' circumspection may be that Megarry V-C's formulation of the duty appears to be the first reported instance of a court in the UK or Australia formulating a trustee's duty in precisely this way.[171] Though present in other areas of the law, such as company law[172] and welfare law,[173] the notion of 'best interests' is not a traditional element of trust law. [174] Until Megarry V-C's judgment, the duty of trustees was expressed to be to act in the interests of their beneficiaries; there was no reference to 'best'. [175]

This would be of only semantic interest if the content of the duty Megarry V-C sought to delineate using the phrase 'best interests' was unambiguous. However recent commentators have started to recognise the ambiguities present in Megarry V-C's 'best interests' formulation.[176]

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171 Xenia Frostick, 'Is there a duty to act in the best interests of beneficiaries?' (2000) 83 *Pension Lawyer* 2; Hulme, above n 168.

172 *Corporations Act 2001* (Cth), s181.

173 For instance Section 60 CA, *Family Law Act 1975* (Cth). Other examples drawn from the welfare arena include persons incapable of managing their affairs by reason of mental disorder (under the *Protected Estates Act 1983* (NSW)), the aged and infirm (under the *Aged and Infirm Person's Property Act 1940* (SA)) and adopted children (under the *Adoption Act 2000* (Cwth)).

174 The Privy Council in *Oakes v NSW Commissioner of Stamp Duties* [1953] 3 ALL ER 1563 talks of the 'best interests' of certain minors who are the beneficiaries of a trust. The phrase is used in a natural way and not, as here, as a term of art. Moulton LJ also gets close in *Osborne v Amalgamated Society of Railway Servants* (1909) 1 Ch 183 when he talks about 'what is best in the interests of those for whom he is trustee', at 187.

175 Notably Megarry V-C himself made no use of the phrase in the four editions of *Snell's Equity* (editions 24-27) for which he was editor.

176 See for instance John Lehane, 'Delegation of Trustees' Powers and Current Developments in Investment Funds Management' (1995) 7 *Bond Law Review* 36;

Their qualms are justified. To see why, it is instructive to see the formulation *in situ*. The relevant passage states:

> The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests.[177]

Three familiar strands of equitable principle make appearances in the paragraph; the duty of trustees to be impartial between beneficiaries: the duty of trustees to avoid conflicts between their own and their beneficiaries' interests; and the duty of trustees to seek to give effect to the trust. Each of these duties is familiar to trust law, and indeed they may be said between them to contribute much of the corpus of trust law. However it is impossible to ignore the fact that it is unusual for them to be interlaced in the way chosen by Megarry V-C. There is also no obvious logic to the order in which the obligations are introduced, nor a clear link between them and the putative duty on trustees to act in the 'best interests' of their beneficiaries.

Though post-curial commentary is by no means authoritative, it is nevertheless interesting to note that Megarry V-C, writing extra-curially five years after *Cowan v Scargill,* claimed that he did not believe he was making new law when deciding the case.[178] This explanation is circumstantially supported by the fact that he cited no authority in his judgment for any of the assertions, which suggests that he believed

Hulme, above n 168; Michael Vrisakis, 'The best test of (or the 'bestest') interests of members', (2006) 17(9) *SLB* 138; Michael Vrisakis, 'Section 52 – covenants, copyright and cleanskins (not to mention doppelgangers and leviathans)' (2007) 18(2)&(3) *SLB* 24; Ellen Liondis, 'Errors, breaches and covenants – common threads from the s 52(2) cases' (2007) 18(7) *SLB* 81; Stone, above n 169; Geraint Thomas, above n 169.

177 Above at n 161,286-7

178 Sir Robert Megarry, 'Investing pension funds: the Mineworkers' case' in T G Youdan, (ed) *Equity, fiduciaries and trusts*, (LawBook Company, 1989), 115.

them to be descriptions of principles whose existence and content were uncontroversial. It therefore seems unlikely that Megarry V-C intended to describe a 'new' duty when he used the phrase. The more plausible interpretation is that Megarry V-C intended the phrase to describe in one place both the orientation required of a trustee (that of the beneficiaries' interests) and the intensity of focus required (a single-minded pursuit of what is 'best'). As we shall see below, neither of these elements is inconsistent with familiar trust law principles. Importantly, such an interpretation of Megarry V-C's formulation would enable s 52(2)(c) to play a valuable and pivotal role in the regulatory scheme, orientating trustees towards the interests of members and catalysing an intensity of diligence and care in pursuit of those interests.

First, though, it is necessary to briefly review the reception given by the courts to the notion of a duty to act in the 'best interests' of the trust's beneficiaries. In summary, the archaeology presented below finds that the courts have only recently engaged fully with the ambiguities present in Megarry V-C's judgment. Initially the courts bypassed reference to Megarry V-C's protologistical[179] formulation altogether. However more recently, curial engagement with the phrase and its meaning have increased to the point where, though no final resolution has been reached, important aspects of the notion can be identified. This evolution is traced below.

"Studied Indifference": The Blockbuster Pensions cases (1983-1995)

The courts' attitude in UK pensions cases decided in the first decade after *Cowan v Scargill* can best be described as 'studied indifference'. The phrase does not appear in any of the judgments in *Re Courage Group's Pension Schemes v Imperial Brewing,*[180] *Mettoy Pension Trustees v Evans,* [181] *Davis v Wallington Industries*[182] nor

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179 At the risk of engaging in divination of curial intent, Megarry V-C's formulation is here described as 'protologistic' rather than 'neologistic' because he appears to be proposing the phrase enter the trust law vernacular. 'Neologistic' would be more appropriate if the creation of the phrase (or rather its new application to trust law) was inadvertent.

180 [1987] 1 All ER 528.

181 [1991] 2 All ER 513.

Imperial Group Pension Plans v Imperial Tobacco.[183] Alhough no doubt aware of Megarry V-C's formulation, the courts declined to apply it even in cases where it would appear to have central relevance, such as *Nestle v National Westminster Bank*,[184] a case apparently ready-made for the application of Megarry V-C's formulation. In each of these cases the court looked to the duties of trustees with respect to their members and to the trust and yet there was no mention of a duty to act in the best interests of members, nor any mention of *Cowan v Scargill* in respect of its other propositions regarding the application of trust law to pensions funds.

A similar level of disinterest was shown in Australia. Though the Supreme Court of NSW cited *Cowan v Scargill* in *Lock v Westpac*[185] for the proposition that superannuation trustees are subject to the same obligations as those in a traditional trust, it made no mention of a duty to act in the 'best' interests of members, preferring instead the more traditional duty to act in the interests of members.[186]

Finally, it should be noted that the courts were apparently quicker to adopt the notion of a duty to act in the best interests of beneficiaries in respect of charitable trusts. Both Chancery[187] and the Scottish Court of Session[188] were prepared to apply Megarry V-C's formulation in cases before them. Whether this reflects the nature of that jurisdiction (and the strong flavour of paternalism that pervades it) or simply the predilection of the judges involved is unclear. These isolated examples do not, however, appear to have had an impact on the pace with which the courts adopted the 'best interests' duty in respect of pension or other non-charitable trusts.

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182 [1991] 2 All ER 563.

183 [1991] 2 All ER 597.

184 (1988) but not reported until (1996) 10(6) *TLI* 112, and on appeal, [1993] 1 WLR 1260.

185 *Lock v Westpac* (1991) 25 NSWLR 593.

186 Ibid, 607-610.

187 *Harries v Church Commissioners for England* [1992] WLR 1241, 1246 (Sir Donald Nicholls V-C).

188 *Martin v City of Edinburgh* (1988) SLT 329.

"Flirtation": Specialist Pensions Cases (1995-2005)

A duty to act in the 'best interests of beneficiaries' was discussed in a handful of specialist superannuation and pensions cases between 1995 and 2005.[189] None of the cases turned on the precise content of the phrase and no consensus on the content of the duty emerges from the case law. Indeed the judgments link the duty to act in the best interests of beneficiaries to different strands of trust law, as dictated by the circumstances of the case. *Asea Brown Boveri Superannuation Fund v Asea Brown Boveri*[190] for instance, emphasizes its relation to the duty of loyalty. *Edge v Pensions Ombudsman*[191] sees best interests as a combination of impartiality and proper purpose. *Knudsen v Kara Kar*[192] and *Hillsdown Holdings v Pensions Ombudsman*[193] emphasise the link to proper purposes, and *Alexander Forbes v Jackson*[194] emphasises the link to the duty of impartiality.

The lack of consensus displayed by these cases is a challenge to anyone who would attempt to tie the definition of 'best interests' to a single strand of trust law.

189 It also appears without elaboration in *Moloney v Bell Securities* [2005] QSC 013 (an insolvency case), [55], in *Crowe v SERF* [2003] VSC 316 (a superannuation case concerning the right of members to access to information), [29], in obiter dicta in *Youyang v Minter Ellison* (2003) 196 ALR 482 (a solicitor's negligence case), 492, in *Fuller v Evans* [2000] 1 All ER 636 (a case concerning a trust for the maintenance and education of the settlor's children) and in *Breen v Williams* (1995) 186 CLR 71 (a medical negligence case), 137.

190 [1999] 1 VR 144. This is appears to be the view taken by Davis in Noel Davis, *The Law of Superannuation in Australia*, (Butterworths, 2005), 13,020.

191 [1999] 4 All ER 546; This view accords closely with the view expressed by Lord Nicholls extra-curially:

> To define the trustee's obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different words, a trustee's obligation to promote the purpose for which the trust was created.

Lord Nicholls of Birkenhead, 'Trustees and their Broader Community: Where Duty, Ethics and Morality Converge' (1995) 9 *Trust Law International* 71.

192 (2000) NSWSC 715.

193 [1997] 1 All ER 862.

194 [2004] EWHC 2448.

However, the multivalence is consistent with the view expressed by Thomas[195] and in this Thesis, that the 'duty' to act in the best interests at general law is rather a compendium expression orientating the trustee towards the interests of the beneficiaries and marshalling the more familiar duties in pursuit of those interests.

"Engagement": Invensys, Re VBN and Manglicmot

The most recent stage in the evolution can be seen in *Invensys v Austrac Investments*[196] and *Manglicmot v Commonwealth Bank Officers Superannuation Corporation*.[197] Both cases address directly the content of the phrase 'best interests' in the context of the statutory provisions of the *SIS Act*. Dicta in a third case, *Re VBN,* that came before the AAT should be treated as expressing views inconsistent with, and now superseded, by curial authority.

The court in *Invensys v Austrac Investments*[198] was asked to consider the legal aspects of a proposed division of the funds surplus between the members (in the form of augmented benefits) and the company (by way of repatriation). In the course of his judgment, Byrne J tentatively described the duty to act in the best interests of members, inserted by s 52(c) of the *SIS Act* as a covenant into the trust deed, as:

> an amalgam of two distinct obligations said to be imposed by law upon trustees of a superannuation fund. The first, which is sometimes referred to as the duty of loyalty or the duty of fidelity to the trust, is that to act in the interests of the beneficiaries; that their interests are paramount and must certainly be placed ahead of the Trustee's own interests. Nor may the trustee have regard to considerations which are extraneous to the trust. The second is to pursue to the utmost with appropriate diligence and prudence the interests of the beneficiaries.[199]

195 Thomas, above n 169.

196 (2006) 198 FLR 302.

197 [2010] NSWSC 363

198 Above n 196.

199 Ibid, [107].

This mixes the ingredients in a way very similar to that proposed in this Thesis. The duty of best interests is explicitly linked to the duty of loyalty, as is common in the earlier cases. There is also indirect reference to proper purpose, in so far as having regard to extraneous matters would, *prima facie*, be evidence of an improper purpose. However the requirements for a trustee to act with prudence and diligence are introduced directly for the first time. This is consistent with the compendious interpretation of best interests proposed here.

Also importantly, the benchmark level of exertion (diligence) required from the trustee appears to have been raised. 'Pursue to the utmost' is a high benchmark indeed. This impression is reinforced by his Honour's observation that the obligation will:

> commonly come into play where it is a question whether the trustee of a trust whose objective is to confer financial benefits on beneficiaries has sufficiently pursued these financial interests. [200]

The AAT decision in *Re VBN*[201] was discussed in Part 5.2 above. In that case the AAT was reviewing a decision by APRA to disqualify certain individuals from acting as directors of a corporation acting as a trustee for a number of superannuation funds. Pertinently for the purposes of this Thesis, the AAT saw the administrative law context of s 52(2)(c) as severing the connection between s 52(2)(c) and its general law antecedents. As was noted in Part 5.2, commentators have voiced concern with this finding[202] and, with respect, the ambiguities identified by the Tribunal are capable of more obvious interpretations. It is contended here that the more natural interpretation to be drawn from the sources cited in the judgment of the AAT is in fact the one that ties s 52(2)(c) to the general law.

This would now appear to have been confirmed in the most recent case to consider s 52(2)(c): *Manglicmot v Commonwealth Bank Officers Superannuation Corporation.*[203]

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200 Ibid, [107].

201 [2006] AATA 710.

202 But cf. Davis, above n 190, 81,060.

203 [2011] NSWSC 204.

This case revolved around whether the trustee failed to act in the best interests of members when it entered into an insurance contract on behalf of members that did not cover circumstances that would have been covered under similar contracts entered into by the trustee previously. Justice Rein at first instance in the Supreme Court of NSW[204] found in favour of the trustee. The Court of Appeal upheld Rein J's decision, Young JA and Whealy JA concurring with the judgment delivered by Giles JA. Both Rein J[205] and Giles JA[206] found that the content of ss 52(2)(c) was contiguous with the general law duty. Neither took the opportunity to describe that content, but rather expressed support for the description provided by Byrne J in *Invensys*.

The current position

Section 52(2)(c) means that there is no question whether trustees of superannuation funds owe a duty to act in the best interests of members. Section 52(2)(c) ensures that they do. The question is whether the duty expressed in s 52(2)(c) can draw meaning from its general law analogue. The argument here is that it can and that it ought to. The case law provides an interpretation of the phrase that compendiously includes a range of familiar trust law duties not expressly included in s 52. That alone would make it valuable for the regulatory scheme. Moreover, as we shall see, the notion, expressed by Megarry V-C, that the duty is 'paramount'[207] reminds us not to overlook the relationship between all various duties owed by trustees.

First however it is necessary to excavate a little further the ramifications of the use of the words 'best' and 'interests.'

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204 *Manglicmot v Comonwealth Bank Officers Superannuation Corporation Pty Ltd* [2010] NSWSC 363.

205 Above n 203, [53].

206 Ibid, [121].

207 Above n 161, 287.

The use of the adjectival superlative, 'best'

What is to be implied from the inclusion of the adjectival superlative 'best' in s 52(2)(c)? The discussion above suggests it seems most likely that it was intended as part of the composite term 'best interests'. However that is not the end of the discussion. The use of the word 'best' itself has some important implications.

First, 'best' is 'comparative' in the sense used in *Skea v Minister for Immigration, Local Government and Ethnic Affairs*.[208] It implicitly anticipates the existence of alternatives that are less satisfactory. Put simply, you cannot have a 'best', without alternatives which are, on some basis, 'worse'. Moreover it is a superlative. It is not 'better', which, though it would imply alternatives that are worse, would still permit the possibility of alternatives that are better still. It is 'best'. From this perspective the duty therefore loses its binary nature ('in the interests'/'not in the interests') and becomes a search amongst competing alternatives, for the one (the 'best') that dominates all others at the time when the decision has to be made.

The use of the word 'best' thus counters any suggestion that trustees can settle for a 'reasonable' or satisfactory outcome. This might give pause for thought to trustees seeking to negotiate with external parties, such as employers (in the event of a plan for repatriation of an actuarial surplus)[209] or agents (such as investment managers and other service providers to the trust). At the very least, it suggests that trustees need to take the task of achieving the best possible outcome very seriously.[210] They cannot afford simply to acquiesce to ambit claims that might be offered by the other party to the negotiation and must seek to achieve the best outcome practically possible for their members.

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208 (1994) 51 FCR 82, 85.

209 As was the case in *Hillsdown*, above n 193.

210 See for instance Byrne J's findings in *Invensys*, above at n 196. Also *Asea Brown Boveri,* above n 190. See also Gino Dal Pont, 'Conflicting Signals for the Trustee' Duty to Invest', (1996) 24 *Australian Business Law Review* 140.

This also implies a more intense analysis and greater attention to the needs of the trust than was traditionally required at trust law. As Getzler has noted,[211] there was considerable latitude available to trustees under Jessel MR's classic formulation of a trustee's duty of care in *Re Speight; Speight v Gaunt*.[212] Even Lindley LJ's dictum in *Re Whiteley*[213] that trustees should act as would ordinary prudent men (sic):

> minded to make an investment for the benefit of people for whom he felt morally bound to provide

does not set the standard of diligence required especially high. The insertion of 'best' into the formulation implies more. As Thomas describes it,

> The duty is in part an exhortation to a trustee to do his/her best[214]

The inclusion of the word 'best' would seem, therefore, to endow the covenant with a role in intensifying other, traditional trust law duties such as the duty of care. We will return to this complementarity of the 'best interests' duty with other duties in the discussion of s 62 in Part 5.5 below.

Secondly, it is worth noting that 'best' is not an absolute standard in the context in which it is used here. It can only be gauged by reference to the interests of the beneficiaries. So for instance a decision to invest trust assets in a very conservative investment strategy might be the 'best' one for a superannuation trust the members of which have a low risk tolerance, but would be wholly inappropriate for a superannuation trust the members of which need to achieve high returns in order to meet their retirement income needs.

Finally, it is important to note that the use of the word 'best' here does not transform the method by which execution of the duty or exercise of the power is to be assessed. It remains an *ex ante* test. That is, curial focus will be on whether the decision was the best that could have been made at the time based on the

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211 Joshua Getzler, 'Duty of Care', in Peter Birks and Arianna Pretto (eds), *Breach of Trust* (Hart, 2002), 41.

212 (1883) 22 Ch D 727.

213 (1886) 33 Ch D 347, 355.

214 Thomas, above at n 169.

information available and subject to the constraints then applying, not on whether that decision proved, in fact, to have been the best that could have been made, based on an ex post evaluation of results.

The reference to the 'interests' of beneficiaries

There is one respect in which the precise nature of the putative general law duty is clear. The 'interests' of a beneficiary in trust law are defined as being those enjoyed *qua* beneficiary.[215] That is to say, trustees must have regard only for the impact of their decisions on the benefits provided through the trust. They must regard the presence of collateral benefits accruing outside the trust as irrelevant to their deliberations. This narrow focus is sometimes seen as blinkered. There are frequent calls for superannuation fund trustees to have regard for the 'bigger picture'. This point is taken up in Part 5.5 below, where the proper purpose doctrine is discussed in some detail and some specific examples are examined.

One example is however worth discussing briefly here. The US case of *Blankenship v Boyle*[216] is sometimes cited as an example where the court had regard to beneficiaries' interests outside the trust. In that case, the trustee was permitted by the court to allocate a large portion of its portfolio towards the purchase of securities in a single issuer, the City of New York. Such a large investment in a single, almost insolvent, issuer was agreed to be in breach of the trustee's 'duty' to diversify. In exonerating the trustee, the Court was prepared to have regard for the fact that in so investing the trustee was in effect bailing out the employer of many of the members of the fund, enabling them to keep their jobs.

Fairly obviously, *Blankenship* is not authoritative in Australia. However the thinking in that case is not as foreign as it may superficially appear. The courts in Australia and the UK routinely have regard for the context in which trusts operate. So although an Australian court would not have regard for the interests of superannuation fund members *qua* employees, there may be circumstances when it

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215 *Cowan v Scargill*, above n 161.

216 329 F Supp 1089 (1971).

is in the interests of the members *qua* beneficiaries to have the assets of trust invested in the way seen in *Blankenship*. Perhaps an ill-diversified portfolio that sustains the employer (and hence the superannuation trust) as a going concern is to be preferred over a well-diversified one that has to be wound up whilst in deficit because the employer is in financial difficulty. The trustees in that case would obviously have to make an assessment whether the extension of debt finance to the employer entity would be likely to bring about an improvement in the financial status of the fund. Notably though, that is an assessment directed towards securing the interests of the members qua members, not *qua* employees. The fact that some members' employment prospects may be more secure as a result of the trustee's action would be a collateral benefit that ought not, of itself, invalidate the trustee's decision.

It should also be added that 'interests' here narrowly denotes the beneficiaries' 'financial' interests. Though courts typically now cite Megarry V-C's dicta in *Cowan v Scargill*[217] in support of this principle,[218] there is little doubt that this element of the judgment in *Cowan v Scargill* accurately reflected the general law at the time, and continues to do so. The limited exceptions alluded to by Nicholls V-C in *Harries v Church Commissioners for England,*[219] reflect the unique context of (some) charitable trusts. They do not apply to superannuation funds.

A 'paramount' duty?

There is one final issue with respect to Megarry V-C's judgment that is illuminating in the context of s 52(2)(c). That is his statement that the protologistic duty is

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217 Above n 161 287, 289.

218 See for instance *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2010] NSWSC 363 (issue not addressed on appeal); *Condell v Moore* (1998) Unreported judgment of Chancery; *Martin v City of Edinburgh District Council* (1988) SLT 329; *Will and Estate of William Lionel Buckland dec'd,* above n [ ], 13. In a slightly different context, see *Willett and Anor v Futcher* [2004] QCA 30.

219 [1992] WLR 1241, 1246-7.

'paramount'.[220] This proposition, if accepted, would have important implications for the relationship between s 52(2)(c) and the other covenants in s 52.

The notion that the duty is paramount has received no more than lukewarm support. In those cases where Megarry V-C's judgment has been quoted, the segment describing it as 'paramount' has typically been included. Only in two cases has the court demonstrated any engagement with the notion. In *Asea* Beach J replaced the term 'paramount' with the more explicit adjective 'overriding' in summarizing Megarry V-C's dicta. [221] However the weight to be accorded to this reference, appearing *obiter dicta* and without elaboration, is moot. This rephrasing was also used by Balmford J in *Crowe v SERF.*[222]

More importantly, though, in cases where the priority of the best interests duty over other duties might actually have mattered, such as where it came into conflict with the duty to exercise a power for a proper purpose, the courts have been more inclined towards respecting the purpose of the power than establishing an overarching obligation to act in the best interests.[223] Indeed it is hard to see how this relative priority could not prevail; the purpose of the trust provides the definition of the beneficiaries' interests.[224] Whether this relative priority would apply when the protologistic duty comes into conflict with other traditional trustee duties is however a matter for speculation.

This question of relative priority is not simply an issue for trust law. There is an important parallel in the statutory context. As noted above, s 52(2)(c) is embedded within a series of provisions that together are intended together to guide trustees of superannuation funds in the performance of their duties and exercise of their powers. Its sibling provisions in s 52(2) embed into the trust instrument covenants

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220 Above n 161, 287. Pollard notes the novelty and inscrutability of the term 'paramount' in this context. David Pollard. 'Trustees' duties to employers: the scope of the duty of pension trustees' (2006) 20 *Trust Law International* 21, fn 26.

221 Above n 190, 159.

222 [2003] VSC 316 [29].

223 *Hillsdown Holdings,* above at n 193. See also Pollard, above n220.

224 See for instance *Pikos Holdings* v *Territory Homes* [1997] NTSC 30, [9] (Kearney J).

imposing a duty to act honestly, to exercise due care, skill and diligence, to keep trust assets separate, to formulate an investment strategy appropriate to the needs of the fund, and to provide designated information to beneficiaries.[225] On most interpretations, s 52(2)(c) would seem to overlap with these duties. It is hard to imagine how a dishonest act, or a careless one, would still be in the best interests of beneficiaries, for instance. This, together with the role of s 350 in conserving the background tapestry of general law principles, inspire the conclusion that Parliament intended that the s 52 'duties' be seen as part of an integrated, coherent, cohesive and complementary whole, not as separate and independent rules.

This finding is important on two dimensions. It suggests that the duties articulated in the *SIS Act* should be interpreted together. So for instance it means that s 52(2)(c) will be relevant in the application of s 62, the sole purpose test, intensifying the focus of that test on the needs of members, narrowly defined. This will be discussed further in Part 5.5. It also means that s 52(2)(c) will be relevant, alongside s 52(2)(b), the covenant requiring the trustee to act with the care, skill and diligence of a prudent person, and s 52(2)(f), the covenant requiring the trustee to formulate and give effect to an investment strategy, in the trustee's exercise of the investment power.

Secondly, it inspires the possibility that in light of the ambiguity at trust law concerning the content of the protologistic duty of 'best interests,' that phrase could be interpreted expansively to connote the wider range of specific duties described above. This would have the effect of importing requirements not specifically mentioned in the *SIS Act,* such as that of impartiality[226] or the requirement to avoid conflicts of interests and duties.[227] Both of these familiar duties were identified as

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225 *SIS Act*,s 52(2)(a) – (h).

226 Notably, the duty is separately provided for in the *Trustee Acts* of the States; *Trustee Act 1925* (NSW) s14B(2)(c); *Trusts Act 1973* (Qld) s23(2)(c); *Trustee Act 1936* (SA) s8(1)(c); *Trustee Act 1898* (Tas) s9(1)(b); *Trustee Act 1958* (Vic) s7(2)(c); *Trustees Act 1962* (WA) s19(1)(c); and in the sections of the *Corporations Act* pertaining to responsible entities; Sections 601FC(1)(d) and 601FD(1)(d).

227 This was discussed in Part 4.1.

'core' trustee duties by the Law Reform Commission but failed to make the final list of s 52(2) covenants.[228] That approach would be consistent with curial comments since *Cowan v Scargill*, and crucially, would help to supply content in areas where the *SIS Act* is currently apparently deficient.

The statutory duty to act in the best interests of beneficiaries may therefore be transcendent. Though the s 52(2)(c) duty may not be 'paramount' in the sense that it would eclipse other duties were there to be a conflict, it may nevertheless 'marshal' those other duties in some circumstances, and perhaps intensify the focus in others. It may even invoke others not expressly listed in the *SIS Act* such as the duty to act impartially and to avoid conflicts of interests and duties, of which more will be said in Chapter 6.

Summary of Analysis

Parliament's intent in s 52 was expressly to ensure that a set of minimum standards of trustee behaviour was imposed across the system to safeguard the interests of superannuation fund members.[229] That the trust law precept on which s 52(2)(c) was modelled was less precisely defined than Parliament appreciated does not render its inclusion nugatory. It does however mean that some care must be taken in discerning precisely the content of the duty so imposed. The analysis above inspires the following propositions:

1. The statutory duty to act in the best interests of members imposes a positive obligation on trustees to seek the optimal course of action;
2. The optimal course of action is defined by reference to the needs of the members qua beneficiaries;

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228 Law Reform Commission, *Superannuation* (1992), [9:19], [9:21]. Notably the recommendation with respect to impartiality was to exercise discretions fairly as between members; only one half of the impartiality condition identified by Paul Finn, *Fiduciary Obligations* (LawBook Company, 1977), at [94].

229 Dawkins, *Strengthening Super Security* (1992), 6.

3. Optimality is to be judged *ex ante*, based on the knowledge available and circumstances prevailing at the time the decision was taken;[230]
4. The duty is owed to the beneficiaries as a whole and not to individual beneficiaries, since trustees are required to exhibit loyalty (to the interests of the beneficiaries), fidelity (to the terms of the trust) and impartiality (between beneficiaries) on the part of the trustee; and
5. Though the s 52(2)(c) duty can operate on its own, it also provides impetus to other trustee obligations, such as the duty to act with care, skill and diligence (s 52(2)(b)).

This interpretation of the content and span of s 52(2)(c) relies in large part on the relationship suggested here between s 52(2)(c) and Megarry V-C's 'paramount' duty. The uncertain provenance of the duty described by Megarry VC means that the relationship is more complex than that between s 52(2)(b) and the general law described in Part 5.3; here trust law does not merely supply content that calibrates the rule but also a way to understand how the various trustee duties imposed by the s 52(2) covenants might relate *inter se*. It also provides relevant guidance in practical situations discussed in the next section.

Practical Examples

There are a myriad of real-world situations in which the duty to act in the best interest of the beneficiaries could be expected to have an influence. Two such situations, both related to the contemporary practice of providing member investment choice, are considered below: first, formulating the investment strategy for the fund's default option and second, designing the architecture (or 'menu') within which the choice is made.

The Choice of the "Default" Strategy

In 1993 when the *SIS Act* came into force, trustees of most superannuation funds formulated a single investment strategy for each class of beneficiary of their fund.

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230 *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426, 448.

Investment decisions of this type are in fact a key part of the traditional role of a trustee[231] and the *SIS Act* gives statutory backing to a number of traditional obligations in respect of the exercise of the investment power. So, as we saw in Part 5.3, the effect of s 52(2)(b) is to impose a duty on the trustee to act with the care, skill and diligence of a prudent person and s 52(2)(f) requires that the trustee must have regard to the circumstances of the fund, to its appetite for risk, return, diversification and so on in designing the fund's investment strategy.

Section 52(2)(c)'s contribution to the tapestry of duties is effectively to require that trustees have regard for the members' best interests when designing and implementing the strategy. This requires trustees to balance the competing interests of members whose timeframe for continued membership, or whose tolerance for risk, might span quite a wide range.

The advent of member investment choice means that the situation today is slightly different, but the practical issue for trustees remains. The members of most superannuation funds in Australia today are offered a choice of investment strategies for their accounts.[232] If a member fails to nominate a specific investment option, his or her contributions are typically placed in the so-called 'default' option. Consistent with overseas experience, the majority of assets in Australian superannuation funds reside in the 'default' options offered by those funds.[233] This

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231 *Re Boston's Will Trust* [1956] Ch 395, 405 (Vaisey J).

232 Approximately 90% of corporate, industry and public sector funds now offer member choice; APRA, *Annual Superannuation Bulletin* (2006), 31. Master funds, a retail investment vehicle also used for superannuation investment, have been excluded from this calculation because the role of both the trustee and the default option is more complicated than in the paradigm case primarily considered here.

233 As at 30 June 2006 this stood at approximately 66% based on the cohort described in APRA, above n 232, 31. For UK and US findings, see Alistair Byrne, 'Investment decision making in defined contribution plans' (2004) 10 *Pensions* 37, 43. There is the possibility that some members actually choose the default option. To date there has been little empirical study of the extent to which each of the two possibilities is responsible for the assets found in default options, and the assumption has been made that the 'no nomination' cohort vastly exceeds those who specifically choose the default option. See for example Alistair Byrne, 'Employee Saving and Investment

poses a practical issue for the trustees of the fund. Having failed to provide a direction, members leave to the trustee the task of determining what strategy is in their 'best interests'.

So what does s 52(2)(c) offer in this context that is not otherwise covered by s 52(2)(b) and s 52(2)(f)?

The members invested in the default option of a large superannuation fund are likely to differ across many dimensions, including age, income, wealth, risk aversion and likely time in the workforce. However the trustee must then convert the diverse set of needs and objectives strategies into a single, consolidated strategy for the fund.

There are a variety of ways this could be achieved. Trustees could attempt to identify a 'typical' member, and adopt a strategy appropriate for that archetype. Or they could recognise that older members, for the most part, have larger balances (and hence in aggregate comprise a greater portion of the fund) and have less time to retirement (and thus potentially a higher risk aversion), and adopt a strategy appropriate to this 'weight of money'. More ambitiously, they could attempt to identify a compromise strategy that is, loosely, Pareto optimal.[234] That is to say, the trustee might attempt to identify a strategy that minimises the average misfit between each individual beneficiary's interest and the strategy decided by the trustee. For many superannuation funds, this strategy is approximately that of a 'balanced fund'. It may not be precisely the strategy chosen by all members, but it is a reasonable compromise across all the needs of the diverse membership. Moreover it could be argued as being close to the notion of impartiality found in trust law, recalling that the duty to act impartially was one of the elements of the duty originally described by Megarry V-C.[235]

Decisions in Defined Contribution Plans: Survey Evidence from the UK' (Discussion Paper, PI-0412, Pensions Institute, 2004).

234 Pareto optimality is the equilibrium state where it is not possible to increase the utility enjoyed by any one party (here a beneficiary) without harming the utility of the others; Paul Samuleson, *Economics* (McGraw Hill, 2nd Australian Edition, 1973), 704.

235 See above n 161.

So would the courts interpret 'best interests' as requiring this type of optimisation? Or would some lower standard be acceptable? Would for instance a policy of mimicking the average strategy of the fund's peer group be acceptable? As we saw in Part 5.3, that approach might be deemed consistent with the notion of prudence, in the sense that it reflects the contemporary behaviour of comparable entities, one of the hallmarks of prudence. However it is arguably contrary to the spirit of s 52(2)(f) of the *SIS Act* which clearly intends trustees to have consider the unique needs and circumstance of the fund for which they are responsible.

Moreover, the influence of analogy would be strong. The fact situation in cases like *Cowan v Scargill*,[236] *Harries*[237] and *Martin*[238] is too similar to the task facing trustees deciding on their fund's default strategy to be ignored. In those three cases the courts approached the problem as though the trustee had a duty to seek the optimal strategy. In each of the cases, the courts were asked to consider whether the suggested limitations to the trusts' investment strategies would prejudice the financial interests of their beneficiaries. In other words they were asked to make an assessment of degree of the type described above. Only in *Martin* was there a question of procedural irregularity (the absence of independent advice). The courts took up the invitation, assessing in each case whether the investment constraints materially compromised the strategy. It seems likely that the courts would apply a similar perspective here.

The main reason why this is important is that the courts have not always been avid pursuers of a requirement to strive for optimality. For instance, as noted above, whilst the Court of Appeal in *Nestle v National Westminster Bank* was highly critical of the investment performance achieved by a professional trustee, it nevertheless declined to find a breach of duty.[239] The statutory incantation of the phrase 'best

[236] Ibid.

[237] Above at n 187.

[238] Above at n 188.

[239] Legatt LJ noted:

interests' might provide the impetus that energises prudence, due care, skill and diligence in the service of fund members, surely one of the key objectives of the regulatory regime.

Member Investment Choice

Determining an appropriate investment strategy for the trust was traditionally the key decision for a trustee.[240] However this has become more complicated with the advent of member investment choice within superannuation funds. In funds that provide investment choice to members, the trustee is effectively excluded from deriving an investment strategy to further the financial interests of fund members directly. However that does not relieve trustees from the duty under s 52(2)(c) to perform their duties and exercise their powers in the best interests of beneficiaries.

The question then arises, just how far does that duty extend where members have the opportunity to direct the investment to invest their contributions in a particular way? A highly paternalistic approach would see trustees responsible for those decisions. So a beneficiary who suffers a loss from having made a choice that was in some objective sense inappropriate for their needs, might have recourse against the trustee that gave effect to that member's direction. At the other end of the spectrum, it is possible to argue that the trustee ought merely to be responsible for giving effect to the decisions taken by the member and not for the suitability of the investment choice made by that member.

> No testator, in the light of this example, would choose this bank for the effective management of his investments. But the bank's engagement was as a trustee, and, as such, it is to be judged not so much by success as by absence of proven default. 142

In this respect the Court of Appeal's finding contrasts the oft-quoted judgment of Hoffmann J at first instance. Hoffmann J's judgment describes vigorous and attentive behaviour on the part of the trustee bank. His finding of no breach was based on a reluctance to impose today's measure of optimality on the decisions taken in decades past; 1988, *Nestle v National Westminster Bank,* above n 184. With respect, this is a sounder foundation for the finding against what appears to have been an unmeritorious claim.

240 *Re Boston's Will Trust,* above at n 231, 405 (Vaisey J).

APRA, in its 2006 *Superannuation Circular No. II.D.1, Managing Investments and Investment Choice*, articulates a position between these extremes, in essence holding the trustee accountable for the decision environment in which the member receives the offer. So for instance, the Circular observes:

> In APRA's view, it is difficult to conclude that a trustee is acting in the best interests of members if narrow or risky choices are made available without regard to the amount or proportion of the member's interest that may be placed in the particular strategy.[241]

It thus marries the paternalism of traditional trusteeship with the practical requirement articulated in s 52(2)(f) of the *Superannuation Industry (Supervision) Act 1993* (Cwth) to formulate and give effect to an investment strategy for the fund. The Circular notes,

> The fact that members may, in limited circumstances, direct their investments does not relieve a trustee itself of the requirement to act prudently, nor can it divest the trustee of its duty to have regard to diversification, risk, liquidity and other factors when setting investment strategies.[242]

This view, albeit positioned some distance from both extremes of the spectrum of views, remains controversial.[243] Indeed a recent report of the Parliamentary Joint

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241 APRA, *Superannuation Circular No. II.D.1, Managing Investments and Investment Choice* (2006), [45].

242 Ibid, [49].

243 See for instance the summary of submissions provided to the Parliamentary Joint Committee on Corporations and Financial Services' enquiry into the superannuation industry: Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *The structure and operation of the superannuation industry*, (Senate Printing Unit, Canberra, Aug 2007), [4.25 – 4.38]. More recently see Ross Clare, 'Developments in the governance of superannuation funds' (Paper presented at 17th Colloquium of Superannuation Researchers, Centre for Pensions and Superannuation, UNSW, July 2009), 13.

Committee on Corporations and Financial Services recommended that APRA revisit the way it expresses this view to make its practical application clearer.[244]

The courts have had limited opportunity to resolve the uncertainty. In *Perpetual Trustees Australia Ltd v Wallace*,[245] Edmonds J was asked to review a determination of the Superannuation Complaints Tribunal relating to a trustee's obligations in respect of an investment choice made by the member of a single member superannuation fund. The SCT found that the trustee had breached its duties under the *SIS Act* in acceding to a member's direction to invest his superannuation monies almost wholly in speculative share investments.[246] In reaching this determination the SCT had regard for the fact that the member was 70, unwell and in receipt of a pension from the fund. The SCT also found that the trustee's decision not to compensate the member for the loss he had suffered as a result of the 'unlawful' investment choice was not fair and reasonable in the circumstances.[247] Edmonds J set aside the SCT's determination. However he did so on grounds relating to the procedural circumstances of the SCT's determination. He was not required to address the fundamental issue, whether the trustee had breached the duties imposed by the *SIS Act* because that point was not argued by the respondent (the trustee) before the court.

There is another point on the spectrum that has some attractions. It is possible to argue that trustees might be required to ensure that the range of options (as opposed to the options individually) is in the best interests of members.[248] From this perspective, trustees might be required to ensure that the suite of options includes options catering to the spectrum of different needs of their members and that the

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244 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate responsibility: managing risk and creating value* (2006), recommendations 9 and 10.

245 [2007] FCA 527.

246 Ibid, 13.

247 Ibid, 13.

248 Scott Donald, 'The prudent eunuch: Superannuation trusteeship and member investment choice' (2008) 19 *Journal of Business and Finance Law and Practice* 5.

costs of making such a suite available do not outweigh its benefits. They might also seek to design choices that are likely to promote good investment practice and that the ways in which members might choose to employ the options are not likely to be financially injurious. This might include limits on the frequency of switching, limits on the maximum allocation to certain riskier options and a requirement for regular (triennial?) re-confirmation of their choices.

But the duty may also encourage a court to find an even broader duty. As noted above, most superannuation fund members leave their money invested in the default option. However, of those who make an independent choice away from the default, the overwhelming empirical evidence shows they go on to make sub-optimal investment choices.[249] Would this be grounds for arguing that even the offer of choice is not in members' best interests? That in exercising their power to make the offer, and perhaps even amending the deed to permit such an offer, the trustee ought to have had regard for the members' best interests, which on the basis of the empirical evidence would suggest that the offer should not be made? After all, 'best interests' in the superannuation fund context is measured in purely financial terms, and it is the interests of the members as a whole that have to be considered.[250]

It would be a brave court, indeed, that would uphold such a contention. The most likely outcome is that the presence of a default option, presumably designed by the trustees after careful deliberation, would most likely provide a compelling defence to any suggestion that the trustees forced members into the investment casino. However trustees would be well-advised to ensure that nothing in the circumstances of the offer, including any relevant communications to members, is capable of fuelling a claim that the mere offer of choice exposed the members to unacceptable

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249 Evidence of sub-rational decision-making in pension plans can be found in Shlomo Benartzi and Richard Thaler, 'Naïve Diversification Strategies in Defined Contribution Savings Plans' [2001] *The American Economic Review* 79 and in Shlomo Benartzi and Richard Thaler, 'How Much is Investor Autonomy Worth?' [2002] *Journal of Finance* 1593. In Australia, see John Evans and King Tan, 'Drivers of Investment Choice: Some Evidence from Australian Superannuation Participants' [2006] *Jassa*, Issue 4, 18.

250 *Cowan v Scargill*, above n 161.

risk of financial detriment. The overarching nature of the best interests duty, both within the regulatory scheme imposed by the *SIS Act* and in trust law seems at least to require that.

5.5 The Sole Purpose test

The final example of the use of trust law in the statutory framework is the so-called 'sole purpose' test found in s 62 of the *SIS Act*. The sole purpose test is designed to orientate the trustee towards pursuit of the primary objective of the superannuation system, namely the provision of a means by which individuals will save during their working lives to accumulate assets to fund their expenditure in retirement.[251] It expressly requires trustees to prioritize this objective to the exclusion of all others. That is the 'purpose' for which the fund must be maintained.

The language of 'purpose' is important here. It echoes the equitable principles relating to the exercise of powers by a trustee. That said, there are important respects in which the drafting of the sole purpose test evinces an intention on the part of parliament to modify those principles. It is even possible to interpret s 62 as eclipsing the substantive effect of the doctrine of powers entirely, though as we shall see the conclusion reached here is that an interpretation that draws on equitable doctrine, and hence trust law, is to be preferred to an overly literal interpretation.

The Statutory Sole Purpose Test

Section 62 is titled 'Sole purpose test.'[252] The relevant parts of Section 62 of the *SIS Act* provide (emphasis added):

> (1) Each trustee of a regulated superannuation fund must ensure that the fund is maintained solely:
>
> > (a) for one or more of the following purposes (the **core purposes**):
> >
> > > (i) the provision of benefits for each member of the fund on or after the member's **retirement** from any [business, trade, etc] in which the member was engaged …;

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251 *Sutherland v Woods* [2011] NSWSC 13, [115].

252 It is ironic therefore that the provision actually lists a plurality of possible acceptable purposes and expressly anticipates the possibility that the fund may be maintained for more than one of the purposes listed.

> (ii) the provision of benefits for each member of the fund on or after the member's **attainment of an age** not less than the age specified in the regulations;
>
> (iii) the provision of benefits for each member of the fund on or after whichever is **the earlier of**:
>
> > (A) the member's retirement ...; or
> >
> > (B) the member's attainment of an age ...;
>
> (iv) the provision of benefits in respect of each member of the fund on or after the member's **death**, if:
>
> > (A) the death occurred before the member's retirement ...
>
> (v) the provision of benefits in respect of each member of the fund on or after the member's **death**, if:
>
> > (A) the death occurred before the member attained the [prescribed] age; ...or
>
> (b) for one or more of the core purposes and for one or more of the following purposes (the **ancillary purposes**):
>
> (i) the provision of benefits for each member of the fund on or after the **termination of the member's employment** ...;
>
> (ii) the provision of benefits for each member of the fund on or after the member's cessation of work ... on account of **ill-health** (whether physical or mental); ...
>
> (v) the provision of such other benefits as the Regulator approves in writing.

In summary, then, s 62 requires trustees to maintain the superannuation fund solely for one or more of the core purposes (the provision of benefits upon a member's retirement, attainment of the official retirement age or death). Section 62(b) softens the impact of the rule, permitting superannuation funds to offer benefits upon termination of employment or ill-health, or for purposes prescribed by APRA, so long as pursuit of those ancillary purposes occurs in addition to provision of benefits pursuant to one or more of the core purposes.

Section 62 has yet to be the subject of any sustained curial analysis. The section is frequently applied in the SMSF context but seldom in the context of large-scale superannuation funds under consideration in this Thesis.[253] With one relatively minor exception[254] its interpretation has never been considered in any detail by a court in either context.

Academic commentators, too, have shown little interest in the provision. It does not even rate a mention in most Australian trust law texts.[255] Dal Pont[256] and Hanrahan[257] mention but do not discuss, the provision. Pearson devotes more space to the section but concludes, perhaps with an eye to the scarcity of cases relating to the section, that 'the sole purpose test is not overly difficult to satisfy.'[258] Given that the courts have not had an opportunity to consider to any great extent the content of s 62, care should be taken before drawing such a conclusion. It seems more reasonable to observe that there remains some uncertainty as to what the courts might make of s 62 should an appropriate opportunity present itself.

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253 See for instance *Amp Superannuation Ltd As Trustee of the Amp Superannuation Savings Trust* [2011] NSWSC 1439, [14]; *Sutherland v Woods* [2011] NSWSC 13; *Invesys v Austrac Investments* (2006) 198 FLR 302, [57]; *Australian Prudential Regulation Authority v Derstepanian* [2005] FCA 1121.

254 *Sutherland v Woods* above n 251, discussed further below.

255 See for instance R P Meagher and WMC Gummow, *Jacobs Law of Trusts* (Butterworths, 6th ed, 1997); Harold Ford, Michael Bryan and P McDermott, *Principles of the Law of Trusts* (Thomson online service) and more general texts such as Michael Evans, *Equity and Trusts* (LexisNexis, 3rd ed, 2012).

256 Gino Dal Pont, *Equity and Trusts in Australia* (LawBook Company, 5th ed, 2011), [28.55].

257 Pamela F Hanrahan, *Funds Management in Australia: Officers' Duties and Liabilities* (Butterworths, 2007).

258 Gail Pearson, *Financial Services Law and Compliance in Australia* (CUP, 2009), 464-7.

A literal interpretation

It is clear that s 62 sets out to define exhaustively the purposes for which a superannuation fund can be maintained.[259] All other purposes are, by construction, therefore improper. But what does that mean for the relationship between s 62 and other sources of law?

The drafting of the provision would seem to leave little room for interpretive assistance from sources outside the section. Read literally, the provision defines the 'core' and 'ancillary' purposes and establishes the all-eclipsing sovereignty of those purposes over all other matters which a trustee might have otherwise considered.[260] Apart from the meaning of the word 'purpose' there would seem to be little opportunity for the general law to contribute to the interpretation of s 62. However, as we shall see, that apparently minor contribution proves to be something of a juristic Trojan horse, permitting the injection of important aspects of trust law's substantivity into the application of s 62.

There is another, even more extreme corollary of the literal approach that must be dispelled before we progress: a strict literal reading of s 62 might eclipse the doctrine of powers altogether. It seems safe to assume that the courts will interpret 'maintained' to encompass all acts and decisions of the trustee. That means that any exercise of a power must comply with s 62. However if the literal interpretation of s 62 were to prevail then any exercise of a power for any other purpose, even one consistent with the purposes articulated in s 62, would contravene s 62.

The most obvious response to such a proposition is that it would cut across s 52(2)(c) quite directly. Recall that the covenant in s 52(2)(c) requires that trustees:

> ensure that the trustees duties and powers are performed and exercised in the best interests of beneficiaries

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[259] Noting, of course that the s 62(1)(b)(v) incorporates purposes approved in writing by the Regulator.

[260] *AAT Case 10,301* (1995) 31 ATR 1067.

A literal interpretation of s 62 would render the reference to powers in s 52(2)(c) otiose.

There is also no indication in the case-law that the doctrine of powers ought not to apply to the exercise of powers by superannuation trustees subject to the *SIS Act*.[261] This despite misgivings, most recently summarised by Smart AJ in *Tuftevski v Total Risks Management Pty Ltd* that the rules drawn from trust law in this area might be inappropriate and deserving of legislative reform.[262] The court may find the strictures of trust law inconvenient or ill-suited to the superannuation context at times[263] but they have shown no inclination to apply s 62 in such an extreme way.

APRA's interpretation of s 62

APRA has documented its interpretation of s 62 in *Superannuation Circular No.III.A.4 The Sole Purpose Test.*[264] The *Circular* is designed to be a practical guide to assist trustees in the execution of their duties. It is relevant here not because it is authoritative (by its own admission it is not) but because APRA's status as regulator means that it is likely to influence trustees' understanding of their obligations.

Close examination reveals that APRA implicitly also does not accept the literal interpretation of s 62. For instance, the *Circular* notes that:

> The sole purpose test is sufficiently broad to encompass the normal activities of superannuation fund trustees, *including* those activities necessary to enable funds to provide retirement benefits.[265] (emphasis added)

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261 See for instance *Invensys v Austrac Investments where* Bryson J noted that:

> It is well established that a power ... to amend the deed of trust is subject to general restrictions imposed by law.

Above n 253, [62].

262 [2009] NSWSC 315, [128].

263 See for instance Bryson J in *Vidovic v Email Superannuation* (Unreported, Supreme Court of New South Wales, Bryson J, 3 March 1995), 11; *Telstra Super Pty Ltd v Flegeltaub* (2000) 2 VR 276, [4], [6] (Ormiston JA).

264 APRA, *Superannuation Circular No.III.A.4 The Sole Purpose Test* (February 2001).

265 Ibid, [37].

The literal interpretation of s 62 would not 'include' within its compass those activities necessary to enable funds to provide retirement benefits; it would be limited to them.

This attitude is even more obvious in respect of 'incidental advantages.'[266] The *Circular* posits a benign attitude to the presence of 'incidental advantages' in the exercise of a trustee's power. Such advantages will not taint a decision of a trustee if:

> the provision of retirement benefits for members is the overriding consideration behind the investment decision[267]

It goes on to note:

> As a guiding principle, there should always be a **reasonable, direct and transparent connection** between a particular scheme feature or trustee action, and the core or ancillary purposes. The more tenuous the linkage between a service or activity and the retirement savings objective, the greater will be the difficulty in the fund meeting the sole purpose test.[268] (emphasis in original)

Such considerations have no place in the strict literal interpretation outlined above.

Finally, the *Circular* notes that 'purpose' is:

> not determined conclusively by what outcomes actually emerge. Rather, its purpose is determined by a judgment of what a fund is organised for and how it achieves this, in the light of an assessment of the totality of its operation.[269]

APRA's view, then, amounts to a watering down of the literal sense of s 62. As we shall see, it does so in ways that are broadly consistent with the approach traditionally taken in trust law to the exercise of powers by trustees. This should not necessarily be a surprise as it is quite likely that APRA was influenced by the general

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266 Ibid, [34].

267 Ibid, [34]. Much of the more detailed discursive content of the Circular occurs in the section dedicated to the exercise of the investment power, so the reference here to the investment decision is merely illustrative.

268 Ibid, [42].

269 Ibid, [8].

law (though no authority is cited in the *Circular* for the views expressed). More generally, though, APRA appears intent on giving s 62 an interpretation sensitive to the commercial context in which superannuation funds operate today, albeit one that goes beyond that which can be sustained from the strict text of the provision. This is consistent with the view that APRA is attempting to use the Circular specifically to influence trustee behaviour and not simply to describe its interpretation of the provision.

Finally it is worth noting that APRA's interpretation of s 62 has another significance that is relevant to this Thesis. The *Circular* appears to be attempting to position s 62 as a complement to the best interests requirement enshrined in the s 52(2)(c) covenant. Specifically, the 'purpose' identified in s 62 provides a criterion for identifying the beneficiaries' 'best interests.' The relationship between s 62 and the s 52(2)(c) covenant are to some extent interdependent, accompanying and reinforcing each other, further emphasising the complex inter-legality that binds the regulatory scheme.

A juridical Trojan horse: the meaning of 'purpose'

The possibility that trust law may have a contribution to make in respect of the interpretation of s 62, notwithstanding what a literal interpretation of that provision might suggest, was introduced above. It arises because s 62 depends crucially upon the concept of a 'purpose.' Purpose is a concept with a specialised meaning in the law. Purpose may be subjective or objective, and is distinguished from the notion of 'motive.'[270] Where 'motive' relates to the reason why the actor made the decision or acted in the way that he or she did, 'purpose' relates to the end the actor intended to achieve (subjective purpose) or the end the action was apt to achieve

270 For an interesting discussion on the relationship between 'motive', 'intention' and 'purpose,' terms that are near synonyms in lay discourse but have specialised meanings at law, see Lord Wright in *Crofter Hand Woven Harris Tweed Co v Veitch* (1942) AC 435, 469. Also the introductory passages in Lionel Smith, 'The Motive not the Deed' in Joshua Getzler (ed), *Rationalizing Property, Equity and Trusts. Essays in Honour of Edward Burn* (Butterworths, 2003).

(objective purpose).[271] It turns out that these notions enhance the ability of s 62 to regulate in respect of certain practical controversies at large in the superannuation context.

A connection to the general law?

It is a moot point whether Parliament intended that the reference to 'purpose' in s 62 to inspire association with such thinking. However there are reasons to believe that such an interpretation is both defensible and desirable.

The first is that the definition of a superannuation fund before the advent of the *SIS Act* was typically expressed as being:

> a fund bona fide devoted as its *sole purpose* to providing for employees who are participants money benefits (or benefits having a monetary value) upon their reaching a prescribed age. [272] (*emphasis added*)

The similarity between s 62 and this formulation suggests, but does not of itself prove, the genesis of the phrase in the general law.

The second reason is more persuasive. *Sutherland v Woods,*[273] the only case so far to consider s 62, implicitly takes this approach.[274] In describing what 'purpose' means in the context of s 62, Hallen AsJ drew on *Raymor Contractors v FCT*[275] to come to the conclusion that:

> One's "purpose" is the object that one has in view or in mind. Generally, one will be said to intend the natural and probable consequences of one's acts and one's

271 *Magna Alloys and Research Pty Ltd v Federal Commissioner of Taxation* (1980) 49 FLR 183, 185 (Brennan J).

272 *Scott v Commissioner of Taxation (No.2)* (1966) 40 ALJR 265, 278 (Windeyer J).

273 [2011] NSWSC 13.

274 Decisions of the Administrative Appeals Tribunal have followed suit. See for instance *Montgomery Wools Pty Ltd As Trustee For Montgomery Wools Pty Ltd Super Fund v Cmr of Taxation* [2012] AATA 61.

275 (1991) 91 ATC 4259.

> purpose may be inferred from his, or her, acts. This is a determination of a person's objective purpose, not their subjective intention.[276]

Raymor Contractors v FCT, in turn, drew on *Magna Alloys,* the case cited earlier in respect of the general law notions of motive and purpose. Therefore apart from the innocent syllogism of ignoring Brennan J's distinction between 'subjective purpose' and 'objective purpose,' Hallen AsJ's conclusion confirms that there is a chain of authority and thinking that links s 62 to the general law concepts articulated in *Magna Alloys*.

Finally, there is a strong echo between s 62 and provisions of the *Income Tax Assessment Act 1936* (Cth) relating to the availability of deductions for contributions made to eligible superannuation funds that were operable at the time when the *SIS Act* was enacted.[277] Those provisions were repealed by the *Superannuation Legislation Amendment (Simplification) Act 2007* (Cth) but curial interpretation of those provisions adopted the specialised legal connotations of the term 'purpose.'[278]

Why might such an association between the statutory provision and the general law be desirable? Simply because it means that s 62 can harness the nuanced substantivity of equitable doctrine, as manifested in the doctrine of powers.

There are two contributions in particular that are important. The first has already been alluded to, the distinction between purpose and motive. The second is the accommodation of subsidiary purposes to the extent that such purposes do not contradict, distract from or compete with the purposes articulated by s 62. The importance of both contributions is highlighted in the illustrations of the real-world application of s 62 that conclude this Part.

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276 Above n 274, [116].

277 The relevant provisions were found in Subdivision AA in Division 3 of Part III of the *Income Tax Assessment Act 1936* (Cth); including ss82AAC, 82AAD and 82AADA.

278 See for instance *Cameron Brae Pty Limited v Commissioner of Taxation* [2007] FCAFC 135, 114 (Jessup J); *Raymor Contractors Pty Limited v FCT* (1991) 21 ATR 1410.

Purpose, as distinct from motive

Section 62 makes no explicit reference to the state of the mind of the trustee. The section does not say, for instance, that the trustee must act in 'what it believes to be' the sole purpose, or that it must 'have regard for' the sole purpose. That does not however mean that the state of mind of the trustee is unimportant. As we saw above, the court in *Sutherland v Woods*[279] was prepared to consider, or if necessary infer from a trustee's acts, the object that the trustee had in mind.

Recall also that s 62 requires trustees to:

> 'ensure that the fund is maintained solely [for one of the core purposes]

The test, then, is whether the purpose for which the fund is maintained aligns with one of those listed in s 62(1)(a) or (b).

The test in s 62 is thus structured is the same way that the doctrine of powers conceives of the test of whether a power has been exercised for a proper purpose.[280] The test applied by a court asked to consider whether the exercise of a power was improper is whether the purpose of the donee matched the intention of the donor of the power.[281] It is therefore not the 'motive' of the donee that is in question, but whether the donee's purpose matched that of the donor.[282] If not, then the court is likely to find that there has been a 'fraud on the power.' [283] Section 62, then, conceives of the test in the same way as the general law.

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[279] [2011] NSWSC 13.

[280] The classic modern exposition of this doctrine is to be found in Geraint Thomas, *Thomas on Powers* (OUP, 2nd ed, 2012).

[281] *Vatcher v Paul* [1915] AC 372, 378.

[282] *Duke of Portland v Topham* (1864) XI HLC 59; 11 ER 1253, 1253. However cf MacLean's nervousness about the 'vigour' of this distinction; D M Maclean, *Trusts and Powers* (Law Book Co, 1989), 93-96.

[283] The classic example of a 'fraud on the power' is where a donee of a power of appointment appoints a person not an object of the trust. See for instance *Duke of Portland v Topham*; above n 282; *Re Farncombe's Trusts* (1878) 9 ChD 652; *Taylor v Allhusen* [1905] 1 Ch 529; *Gilbert v Stanton* (1905) 2 CLR 447; *Re Holland* [1914] 2 Ch 595; *Vatcher v Paull*, above n 281; *Re Wright* [1920] 1 Ch 108; *Re Chadwick's Trusts* [1930] 1 All ER 850; *Re Penrose* [1933] Ch 793; *Re Dick* [1953] Ch 343; *Re Simpson*

One difference, of course, is that unlike the doctrine of powers, which relies on the intention of the donor of the power, s 62 supplies the 'purpose' against which the donee's purpose is to be assessed. That purpose is an important part of the regulatory scheme – along with the duty to act in the best interests of members and the rules relating to preservation and the distribution of any surplus upon winding up, it is designed to ensure that monies contributed to the superannuation system are applied towards the objective of accumulating assets that will be available to fund a member's expenditure in retirement.

The presence of multiple purposes

We have already seen that a literal interpretation of s 62 would not accommodate the presence of purposes other than those articulated in s 62(1) as either core or ancillary. But what if the pursuit of those additional purposes did not compromise pursuit of those core and ancillary purposes?

The doctrine of powers evinces, at first glance, a similar intolerance of additional purposes. It is firmly established that the donee of a power must exercise that power in good faith and for the purpose for which it was granted,[284] or as Lord Westbury LC put it:

> with an entire and single view to the real purpose and object of the power '[285]

Lord Westbury LC's dictum is exacting. However as we shall see in Chapter 7, equitable doctrine is often expressed in terms that are more stringent and absolute than is strictly required to express the substantive effect of the rule.

Here, too, the courts have taken a more moderate stance than is implied in the absolute tone of Lord Westbury LC's dictum. Specifically, the courts have held that

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[1952] Ch 412. However the principles have also been applied in respect of other powers; see for instance *Molyneux v Fletcher* [1898] 1 QB 648 where the power in question was a power of advancement. The principles have also been applied in the superannuation and pensions context directly: see for instance *Re Courage Group's Pension Schemes* [1987] 1 All ER 528; *LGSS v Egan* [2002] NSWSC 1171.

284 *Vatcher v Paull* , above n 281; *Re Simpson* [1952] Ch 412.

285 *Duke of Portland v Lady Topham,* above n 282, 1251.

the presence of potential incidental or collateral benefits will not necessarily taint the exercise of a power. As Parker LJ noted in *Vatcher v Paull*:

> It is not enough that an appointer or some person not an object of power may conceivably derive some benefit.[286]

This approach was applied to the superannuation context in *Invensys v Austrac Investments* where Byrne J was not prepared to impugn the trustee's division of surplus simply because it conferred a benefit on the employer, so long as other relevant requirements (such as bona fides on the part of the trustee) were met.[287]

But under what circumstances might an incidental purpose that is improper taint the decision? It is clear from the authorities that an intention to secure collateral benefits need not be the 'sole' or 'dominant' purpose behind the exercise of the power for the court to intervene.[288] It is also clear that where the power exercised is a dispositive power, it may be possible depending on the circumstances to sever the polluting purpose without doing injury to the rest of the decision (for instance by voiding the appointment of a non-object).[289] However, such an approach may not be possible for a broader range of powers, because it may not be possible to sub-divide the consequences of the decision into parts consistent with a proper purpose (which would be valid) and those tainted by an improper purpose (which would be invalid).

Logic would seem to suggest that in respect of that broader set of decisions, the polluting purpose must at least be capable of influencing the decision taken by the trustee. There is some authority for this, but it is by no means unequivocal. In *Hooke v Robson*,[290] Jacobs J talks of an 'actuating purpose' that he distinguishes from secondary or incidental purposes. In a similar vein, the court in *Re Greaves,*[291] applied a materiality test; only improper purposes of sufficient materiality would

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286 [1915] AC 372, 379. Also *Fuller v Evans* [2000] 1 All ER 636.

287 [2006] 198 FLR 302, [111].

288 MacLean above n 282, 120.

289 Ibid, 121 – 122.

290 [1962] NSWR 606.

291 *Re Greaves* [1954] Ch 434, 447

sufficiently taint the exercise of the power to render it void. MacLean is clearly uncomfortable with such a test.[292] Similarly Thomas reports that this is inconsistent with the weight of authority he has reviewed.[293] In its stead he discerns amongst the early cases a preference for a 'but for' test, albeit noting an absence of support for this more recently. On the other hand Ranero, in reviewing the doctrine of powers in respect of the analogous area of managed investment schemes, identifies a preference for a 'dominant' purpose test within corporate law that he believes reflects an appreciation of the commercial realities in which directors operate.[294] In particular he cites Latham CJ in *Mills v Mills*[295] to the effect that the courts cannot expect:

> an entire exclusion of all reasons, motives or aims on the part of the directors, .. which are not relevant to the purpose of a particular power.[296]

Given that most trustees of superannuation funds (as with managed investment schemes) are corporate entities, this possibility, too, cannot be wholly discounted. It is a matter for speculation as to which of these views prevails in time, but in any case all encourage the conclusion here that in practice the court will not intervene unless it believes the decision was capable of being influenced by the alternative purpose or purposes.[297]

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292 MacLean, above n 282, 119.

293 Thomas, above n 280, [9-69], citing *Pryor v Pryor* [1861-1873] All ER Rep 616 and *Re Turner's Settled Estates* (1884) 28 Ch D 205 217, 219.

294 Franz Ranero 'Managed Investment Schemes: The Responsible Entity's Duty to Act for a Proper Purpose' (1999) 17 *Company and Securities Law Journal* 422, 424, 431.

295 (1938) 60 CLR 150

296 Above n 294, 185-186

297 In substance this is consistent with Thomas' conclusion, that the various formulations are essentially consistent with one another; Thomas, above n 280 ,452.

Concluding Comments

The analysis presented in this Part establishes that s 62 bears more than a passing resemblance to the general law principles governing a trustee's exercise of a power. The resemblance is unlikely to be a coincidence, and APRA in particular appears to be relying on it, but it would be a mistake to conclude that s 62 merely codifies the general law principles.

For a start, s 62 does not simply require trustees to pursue a proper purpose, it also supplies that purpose. So where the general law looks to the intention of the settlor for specification of the proper purpose of the power, s 62 supplies a set of 'proper' purposes in the form of the 'core' and 'ancillary' purposes. These purposes in essence embody the overall objective of the superannuation system, namely to provide a means by which individuals will save during their working lives to accumulate assets that can fund their expenditure in retirement.

Another difference is that the equitable principles focus on individual powers, but s 62 applies the overarching 'sole' purpose (and the ancillary purposes) to all aspects of the management and administration of the trust (its 'maintenance'). Section 62's broad, undifferentiated, approach has the attraction that it promotes cohesion across all aspects of a superannuation fund's administration. All acts and decisions of the trustee and its delegates are to be directed towards pursuit of the sole purpose. The generality does however come at a cost. Its wide scope does not permit fine-grained guidance on issues where the proper approach is not unambiguously obvious. This is one area where the general law principles can play the role described in Chapter 6; the default role. Because s 350 of the *SIS Act* expressly preserves the background general law, the courts can be guided by the general law principles, both on matters of doctrine and in relation to individual powers in areas where the guidance provided by s 62's specification of the 'sole' proper purpose is insufficiently detailed. The two examples described below highlight precisely this relationship. In so doing, they illustrate and further instantiate how the substantivity of trust law is injected into the regulatory scheme.

A practical illustration: Coles Myer Shareholder Discount Cards

Perhaps the most public application of the sole purpose test since the enactment of the *SIS Act* was APRA's intervention over the provision by several large superannuation funds of Coles Myer shareholder Discount Cards to members.

The facts were these: Coles Myer Ltd, a major Australian retailer listed on the ASX, offered to shareholders a discount card to be used in its variously-branded retail outlets. Many, if not most, large superannuation funds had holdings of Coles Myers Ltd shares in their investment portfolios as an ordinary part of their investment strategy. Most did not take up the Discount Card option. However three large industry funds (STA, ARF and C+BUS) sought to give members the benefit of the scheme by providing Coles Myer Discount Cards to members who selected a special 'Coles Myer' fund option.[298] This was apparently a popular move. One, the Australian Retirement Fund, was reported to have over 100,000 members who had taken up the offer.[299] The trustees of a large number of SMSFs also purchased Coles Myer shares in order to participate in the scheme. Initially participation in the scheme was deemed acceptable by APRA and the ATO.

In July 2001 Coles Myer Ltd undertook to create a new class of share to which eligibility for the Discount Card would attach. The dividend stream on this new class of share would be adjusted to reflect the cost to the company of administering the shareholder Discount Card ($50 per annum). This impairment of the dividend stream prompted APRA and the ATO to intervene. Though the official announcements avoided discussion of the reason for the change of heart, contemporary reports quoted a spokesperson of APRA as saying:

> It is the decision to forgo fund income that makes obtaining the card inconsistent with the 'sole purpose test[300]

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[298] Shaun Phillips, 'Battlers lose card benefits.' *Herald-Sun*, 2 November 2001,17; 'Don't do it again, discounters told' *Super Review*, 5 August 2002, 8.

[299] 'Early retirement benefit for few' *Herald Sun*, 27 March 2000, 73.

[300] Statement reported in Phillips, above n 298.

This statement suggests that the determining factor in APRA's intervention was the impact of the fee on the dividend from the new class of share. Though statements of this kind are not formally probative, it accords entirely with the circumstances of the intervention and so there is no reason to doubt that it accurately reflects APRA's rationale. For so long as the benefits were available without affecting the expected returns from the shareholding, the practice had been deemed acceptable by the regulators. This despite the fact that the original shareholder discount scheme could have attracted regulator attention on two grounds directly related to the sole purpose test; the benefits from participation in the Discount Card scheme, though undoubtedly valuable, would accrue 1) outside the superannuation fund and 2) before retirement. Only when the expected returns from the investment were impaired (via the imposition of the fee on the dividend) did APRA and the ATO intervene. It therefore seems fair to surmise that it was the impairment of returns that inspired the intervention, not simply the presence of the 'incidental' benefits.

In reality then, the intervention was based on the combination of the 'best interests' requirement and the sole purpose test, rather than the sole purpose test alone. The fact that the return from the new class of share was necessarily going to be compromised meant it could not be characterized as being in the members' financial best interests, viewed within the frame of reference of the superannuation fund. Invoking the sole purpose test avoided the need for the regulators to labour through the intricacies of the 'best interests' principle when communicating their rationale. However the underlying reality is that it was the best interests principle, not the sole purpose test, that was definitive. This highlights again the important complementary interaction of the various rules governing trustee behavior.

In a similar vein, it is interesting to note that APRA's approach was not the only basis on which the Discount Card option could have been impugned. The minimum shareholding requirement posed a material risk to the diversification of many members' holdings, given the value of the minimum holding in the new class of shares at the time was approximately $4000.[301] Recognizing this, the superannuation funds enforced limits on the portion of each member's balance that could be placed in the Coles Myer investment option, but even these limits still meant that members with small balances were exposed to a major dose of undiversified risk into a portfolio. (The limit was 50% of the member's total balance in the case of ARF, for instance).

Concluding, it is hard not to feel some level of sympathy for the trustees who made the discount card option available to members. They were securing a material financial benefit for members, albeit one that accrued both outside the superannuation fund and before retirement. Moreover, the member could decide whether or not to participate in much the same way that members of retail master trusts can choose from a wide suite of investment alternatives. However this rationale weakened somewhat after the shareholder discount scheme changed. The new scheme was capable of materially distorting the investment decisions of individual members, encouraging them to be distracted by collateral benefits unrelated to the objectives of the superannuation scheme. Taken together with the way in which schemes such as this converted preserved superannuation assets into current consumption, it was not surprising that the regulator intervened.[302]

A second practical example: Sustainable Investing

One area in which the sole purpose test has been invoked publicly is in relation to so-called Sustainable Investing. Sustainable investing is the umbrella term given to a range of investment strategies and approaches that have heightened regard for environmental, social and governance issues.[303] The conventional wisdom until

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301 'Early retirement benefit for few', *Herald Sun*, 27 March 2000, 73.

302 Heretically, though, one is left wondering at the wisdom of restraining members from swapping $50 of dividends within the superannuation system for what was at the time estimated to be a benefit worth approximately $400 per annum.

303 Scott Donald and Nicholas Taylor, 'Does "sustainable" investing compromise the investment obligations owed by superannuation fund trustees?' (2008) 36 *Australian Business Law Review* 47.

recently was that consideration of environmental, social and governance (ESG) issues by trustees was improper.[304] This was based, in part, on the position expressed in cases such as *Cowan v Scargill*,[305] *Harries v Church Commissioners,*[306] and *Martin v City of Edinburgh*[307] that the investment power is to be exercised with the objective of augmenting the value of the fund, not for the purpose of furthering ethical, charitable or social objectives.

More recently there has been sustained pressure from the political arena to encourage trustees and their agents to consider ESG issues. For instance in 2006, the bi-partisan Parliamentary Joint Committee on Corporations and Financial Services expressed the opinion:

> In the committee's view, consideration of social and environmental responsibility is in fact so far bound up in long term financial success that a superannuation trustee would be closer to breaching the sole purpose test by ignoring corporate responsibility. [308]

Given the analysis of the doctrine of powers advanced above, it is possible to take a more nuanced position, one that is less restrictive on trustees than the traditional view but nevertheless respects the substantive effect of trust law.[309] It can be

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304 See for instance Paul Ali, Geof Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries* (LawBook, 2003); Andrew Leigh, 'Caveat Investor: The Ethical Investment of Superannuation in Australia', (1997) 25 *Australian Business Law Review* 341; W A Lee, 'Trustee Investing: Homes and Hedges' (2001) 1 *Queensland University of Technology Law and Justice Journal* 3; Frank Finn and Paul Zeigler, 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' (1987) 61 *Australian Law Journal* 329.

305 [1985] 1 Ch 270.

306 [1992] WLR 1241.

307 (1988) SLT 329.

308 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate responsibility: managing risk and creating value* (2006), [5.41].

309 Scott Donald and Nicholas Taylor, 'Does "sustainable" investing compromise the investment obligations owed by superannuation fund trustees?' (2008) 36 *Australian Business Law Review* 47.

argued that so long as trustees focus on the financial implications of the environmental, social and governance issues they identify, there is no necessary breach of s 62 or the requirement to exercise the investment power for a proper purpose, so long as s 62 is not interpreted in the strict, all-eclipsing manner outlined above.

This approach inspires two issues. The first is whether it is possible to couch ESG issues purely in financial terms. The claim that ESG issues are capable of analysis on a financial basis is a key point of differentiation between the "Sustainability" movement and the "Ethical Investment" and "Socially Responsible Investing" movement that preceded it.[310] The current consensus is that consideration of ESG issues does not necessarily impose a cost on the fund in terms of lower expected performance.[311] Thus consideration of ESG issues cannot of itself be said to compromise achievement of the fund's objective.[312]

Given that finding, the second issue is whether it is permissible for trustees to exercise their powers (in this case the investment power) with an awareness of possible incidental benefits. As noted above, there appears to be very little uncertainty around the proposition that trustees cannot allow the presence of incidental benefits to influence their decision. However, as we have seen, the courts have not impugned trustee decisions where the purpose was proper but incidental benefits have accrued. It therefore seems reasonable to suggest that the broader, more altruistic elements of the Sustainability approach ought not pollute the 'proper purpose' to an extent that would inspire intervention by the courts, so long as the trustee remains focused on pursuing the best interests of the beneficiaries.

The desire in certain quarters to have ESG issues more firmly brought to the fore perhaps in the form of rules directing consideration of ESG issues (or even a

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310 Ibid, 48.

311 Ibid. Also United Nations Environment Programme Finance Initiative, 'Demystifying Responsible Investment Performance' (Report, UNEPFI, October 2007).

312 This does not preclude the possibility of a trustee's actions being impugned for failure to satisfy one of the other requirements in the *SIS Act* or the general law, such as the duty to exercise due care, or to pursue the best interests of members.

requirement to invest on an ESG basis) would therefore seem unnecessary.[313] The need to act in the best interests of members will press trustees to have regard for those aspects of the ESG agenda that have direct, material and proximate financial implications for the funds for which they are responsible, without distorting that assessment by the imposition of legislative restrictions. But that conclusion relies on the courts interpreting s 62 in a purposive, not literal, way and, as the analysis above suggests, such an interpretation, however defensible and desirable, is by no means guaranteed.

313 This was the conclusion reached by the Cooper Review, *Final Report: Part Two*, 182.

Concluding Comments on Trust Law's Interpretive Role

There is a danger that the basic message in this Chapter can be lost in the detail required to explain and illustrate it. The key message is that Parliament deliberately employed trust law language in key provisions of the *SIS Act*. In so doing, it encouraged the courts to employ the equitable jurisprudence surrounding that language when interpreting the provisions. This endows the statutory provisions with the nuance and contingency present in equitable jurisprudence in a succinct and familiar form. The substantive content of key elements of trust law are thus injected directly into the regulatory scheme, sometimes without modification (as in the notion of prudence) and sometimes conditioned by deliberate legislative adjustment (as in the choice of the 'ordinary prudent person' ahead of the 'prudent businessperson'). In each case the rules that emerge allocate accountability within the system in ways intended by Parliament to give effect to its over-arching objectives with respect to member protection and economic efficiency.

It is not just the substantive content of trust law that is injected in this way, however. Another consequence of this approach is that to some extent it endows the statutory provisions with the cognitive structure of equitable doctrine. One example of this is evident in the examples in this chapter: equitable doctrine's ability to evolve, albeit sometimes slowly, to reflect contemporary technology, standards and expectations. That attribute is both valuable and hard to create artificially in statutory form. As we saw most particularly in respect of s 52(2)(b), the use of trust law in this way implicitly attaches the statute to the underlying process of evolution that trust law itself undergoes as its standards evolve in response to changes in technology, standards and expectations. Another example is the reliance by equitable doctrine on 'principles' rather than narrow rules. This is described specifically in detail in Chapter 6 below, but many of the observations made there apply in respect of trust law's ability to play a 'default' role apply here also.

Finally, the drawbacks of employing trust law in this way were introduced in Part 5.2 and instantiated in detail in the Parts that followed. Most pertinently, the analysis of s 52(2)(c) highlighted the complexities that arise when the general law concept itself lacks clarity. Similarly, the analysis of s 62 identified that whether in fact the courts hold that a provision was intended to invoke trust law thinking remains a matter of (informed) conjecture. That said, the richness of equitable doctrine that results from its application to a myriad of circumstances over the span of centuries means that even if the statutory provision does not mirror exactly the general law rule, aspects of the provision can be illuminated by reference to equitable doctrine. In an environment where, as yet, there are few reported cases at an appellate level to assist in the detailed interpretation of key elements of the regulatory regime, such an interpretive resource is valuable indeed.

Chapter 6

Trust law's default role

'Let me therefore sum up how I see the role of equity in the pension world ... It will remain based upon two fundamental features which have characterised equity throughout its history; first that it embodies high-level principles of commercial morality and secondly, that it is a background and supplementary system which interacts subtly and tactfully with a system of more specific lower-level systems. ...

Rt Hon Sir Leonard Hoffmann[1]

The third aspect of the instrumental role played by trust law is to provide 'default' rules in those areas where the statutory regime and the terms of the trust instrument are silent or deficient. This represents a further mode of inter-legality between trust law and other strands of the regulatory tapestry.

Trust law's ability to perform this role is enhanced by the cognitive structure of equitable doctrine. In particular, equitable doctrine's reliance on what Sunstein[2] would term principles, rather than narrow 'rules' gives it a resilience and adaptability that is very valuable. It gives trust law, as one manifestation of equitable doctrine, the ability to address circumstances that were either unanticipated by the legislature or too complex and contextual to be addressed effectively in statute. Its open-textured nature and flexibility is thus complementary to the relative rigidity of the statutory elements of the regulatory scheme.

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1 'Equity and Its Role for Superannuation Pension Schemes in the 90's' (Paper presented at Law Council of Australia Superannuation Conference 1994).

2 Cass Sunstein, 'Problems with Rules' (1995) 83 *Californian Law Review* 956.

There are however several potential shortcomings with using trust law as a source of 'default' rules. The first is that equitable doctrine makes no claim to offer a universal, comprehensive set of rules; it complements and presupposes the existence of the common law. There are also many respects in which distinct elements of equitable doctrine overlap. Thus trust law may be able to supply rules to the regulatory scheme in areas where there are perceived gaps, but it is not ideally suited as a safety net.

There is a good reason for this. Trust law does not purport to supply rules for any or all gaps that appear in the regulatory scheme. In providing rules where it does, trust law is specifically intervening in support of its own pre-occupations and priorities. When trust law intervenes to ensure that trustees act impartially,[3] or free from conflicting interests or duties,[4] it does so not because those rules are not otherwise present in the regulatory scheme but because those are qualities of judgment that equitable doctrine regards as constitutive of the role of trustee. Thus here too, trust law's instrumental contribution is driven by the substantive concerns of equitable doctrine.

3 *Raby v Ridehalgh* (1855) 7 De GM &G 104; 44 ER 41.

4 *Keech v Sandford* (1726) Sel. Cas. T. King 61; 25 ER 223.

6.1 Trust law as a source of default rules

Section 350 of the *SIS Act* expressly provides for the concurrent operation of the *SIS Act* with any law of a State or Territory to the extent that the laws are capable of concurrence. This is taken by most commentators to clarify that the general law of trusts (amongst other sources of law) continues to apply to superannuation funds, so long as it is not expressly eclipsed by a provision in the *SIS Act*.[5] Other sources of law, including trust law, might therefore apply when the statutory framework is silent or deficient.[6]

This permits trust law to play a role analogous to that suggested more generally by Easterbrook and Fischel[7] in respect of fiduciary principles and long term, relational contracts. They argue that the recognition of fiduciary duties in a contractual setting serve as a way to 'flesh out' the duties of the parties *inter se*. They conclude in relation to fiduciary obligations that:

> a 'fiduciary' relation is a contractual one characterized by unusually high costs of specification and monitoring. The duty of loyalty replaces detailed contractual terms, and courts flesh out the duty of loyalty by prescribing the actions the parties themselves would have preferred if bargaining were cheap and all promises fully enforced.[8]

The intent here is not to express support for the contractarian conception of fiduciary duties, *per se*. That is a much larger debate[9] that goes well beyond the limited example of

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5 See for instance Michael Bryan and WA Lee, *Principles of the Law of Trusts*, (Thomson online service), [1.10710]. The role of s 350 of the *SIS Act* was identified but not commented on in *A-G v Breckler* (1999) 163 ALR 576, [33].

6 *Aquilina Holdings Pty Ltd v Lynndell Pty Ltd* [2008] QSC 57, [54] for the proposition that equitable doctrine can affect a relationship otherwise governed by statute.

7 Frank H Easterbrook and Daniel R Fischel, 'Contract and Fiduciary Duty' (1993) 36 *Journal of Law and Economics* 425.

8 Ibid, 427.

9 The literature addressing the 'contractarian' nature of trust law is voluminous. Seminal contributions include John Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *Yale Law Journal* 625 and R Cooter and BJ Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 *New York University Law Review* 1045; Tamar Frankel, 'Fiduciary Duties as Default Rules'(1995) 74 *Oregon Law Review* 1209.

trust law supplying default rules to the regulatory scheme that is being described here. The intent here is merely to identify that the substantivity of trust law is injected into the regulatory scheme not only where such input is express, as in the infrastructure and interpretive roles described in Chapters 4 and 5, but where it is implicitly permitted scope to apply because of the absence of rules derived from other sources. In such circumstances it can supply rules that embody the substantivity of trust law to the regulatory scheme.

The idea that equitable doctrine might play a default role is an old one, possibly as old as the equitable jurisdiction itself. Lord Ellesmere commented almost four hundred years ago:

> the cause why there is a Chancery is, for that men's actions are so divers and infinite, that it is impossible to make any general law which may aptly meet with every particular act, and not fail in some circumstance.[10]

Nor would such a role in the superannuation context be novel. As Langbein notes, in a wide range of commercial contexts:

> one of the great attractions of the trust ... is the convenience of being able to absorb these [trust law] standards into the ground rules for the deal, merely by invoking the trust label[11]

One thing that is different in the superannuation context is that unlike the contracts considered by Easterbrook and Fischel, the regulatory scheme shaping superannuation is not purely consensual. The *SIS Act* has been designed by government specifically to work with private law modalities to promote the achievement of the regulatory objectives identified in Chapter 2. To that end, the 'default' role proposed here is given statutory support by s 350, but it is also implicit in the way that the s 52 operates. As was discussed in Chapter 5, the covenants in that section were expressly intended to reinforce the relevant trust law rules against contrary provisions in the trust instrument. Such an approach

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Recent contributions addressing the relationship between fiduciary duties and contractual relations include James Edelman, 'When do fiduciary duties arise?' (2010) 126 *Law Quarterly Review* 302 and Anthony Duggan, 'Contracts, fiduciaries and the primacy of the deal' in Elise Bant and Matthew Harding (eds), *Exploring Private Law* (CUP, 2011).

10 *Earl of Oxford's case* (1615) 1 Ch R 6; 21 ER 485.

11 John H Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107 *Yale Law Journal* 165.

presupposes that the trust law rules do subsist, but that they are vulnerable to variation or eclipse by the trust deed.[12]

Which rules?

Precisely which rules does trust law contribute in this default role?

One obvious set of candidates would be drawn from those trustee duties identified by the Law Reform Commission[13] that did not make the final 'cut' in s 52(2) of the *SIS Act*. The familiar trust law prohibitions on trustee acting in circumstances in which there is a conflict between the interests of the beneficiaries and either the interests of the trustee or other duties owed by the trustee and also the requirement on trustees to act impartially between members of the same class of beneficiaries stand out in this regard. Both have application in the superannuation context, and the lack of a statutory prohibition on trustee conflicts, in particular, has attracted comment in policy discussions[14] and elsewhere.[15]

Conflicts of interest

Trustees must prefer the interests of their beneficiaries over all others when acting *qua* trustee. As fiduciaries, they must not deal with trust property for their own benefit,[16] nor take unauthorised profit from their position.[17] Nor can they permit themselves to be placed in a position where they owe conflicting duties to different principals.[18]

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12 Dawkins, *Strengthening Super Security* (1992), 6.

13 Law Reform Commission, *Superannuation* (1992), [9.18 – 9.31].

14 See for instance, Cooper Review, *Preliminary Report*.

15 Sir Anthony Mason, 'Superannuation and Conflicts of Interest' (Paper presented at Law Council of Australia Superannuation Conference, February 2005).

16 *Keech v Sandford* (1726) Sel Cas T Ch 61; 25 ER 223.

17 *Re Queensland Coal and Oil Shale Mining Industry (Superannuation) Ltd* [1999] 2 Qd R 524, 526.

18 *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390. See further Matthew Conaglen, *Fiduciary Duty. Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010), Ch 6.

The *SIS Act* does not expressly address the issue of such conflicts. It is possible, as the analysis in Part 5.4 identified, to interpret the covenant to act in the 'best interests' of members imposed by s 52(2)(c) as incorporating the traditional trust law prohibition on conflicts, as Byrne J did in *Invensys*.[19] On the other hand, a requirement:

> to avoid any conflict between the interests of the members and the interests of the responsible entity and, if such a conflict arises, to disclose it to the members

had specifically been included in the list of covenants recommended by the Law Reform Committee that informed the drafting of the *SIS Act*.[20] The absence of evidence leaves it open for commentators and the courts to assume that its absence from the list of covenants in s 52(2) reflects a belief that its substantive effect was redundant because it was subsumed within s 52(2)(c). However it might equally be argued that it was deliberately excluded for some reason that has never been disclosed. In either case s 350 would ensure the continued application of the general trust law relating to conflicts, so, for present purposes at least, the issue is moot.

The main challenge in applying the trustee conflicts rules in the superannuation context comes, then, not from whether the rules apply but from the structural considerations identified in Part 4.3. As we saw in that Part, the interposition of the corporate form as trustee means that the individuals involved in making decisions for the trust owe no duties directly to members other than those imposed by s 52 (8) and, implicitly, by s 55(3). This in turn means that neither statutory nor the trust law elements of the regulatory regime regulate circumstances in which the interests of members might be in conflict with the interests of (or duties owed by) the individuals serving on trustee boards. Nor will losses accruing to the trust as a result of the existence of duties owed by the individuals to other parties give rise to a breach of the individuals' duties.[21] Reliance must rather be placed on

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19 *Invesys v Austrac Investments* (2006) 198 FLR 302.

20 Law Reform Commission, *Superannuation* (1992), recommendation 9.2.

21 The exception, arguably, are interests and duties arising from the employment relation that gives rise to the superannuation contributions, which might be taken to have been anticipated (and implicitly authorised) in the formation of the trust: *Re Drexel Burnham Lambert UK Pension Plan* [1995] 1 WLR 32.

the 'fit and proper' requirements under the trustee licensing regime that require each responsible entity to document and comply with a conflicts policy that includes such circumstances within its ambit.[22] Again, then, trust law contributes a part of the regulatory scheme, in so far as it applies to conflicts between the interests of the trustee and members, but other strands of the scheme, in this case the licensing regime, are also required.

Impartiality

It is also the case that there is no reference in the *SIS Act* to the requirement that the trustee of a superannuation fund must act impartially. Again, though, there is little doubt that the trustees of superannuation fund owe such a duty at general law.[23]

How might such a duty be relevant in the superannuation context? An obvious, albeit hypothetical, example is if a trustee offered different services or product features to a sub-set of members in ways that were not provided for in the trust instrument or, more generally, the governing rules of the fund. Another example, alluded to in Part 5.4, might arise if a trustee formulated an investment strategy for the fund that preferred the interests of one set of members (those approaching retirement, for instance) over other members in a way that was unjustified by the inevitable balancing of interests required to ensure that the strategy had regard for all of the circumstances of the fund. There is no reason to suppose that the duty imposed on trustees by trust law to act impartially would not be available to restrain such partial conduct in both of these circumstances.

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22 APRA, *Prudential Practice Guide, Fitness and Propriety*; SPG 520 (August 2010), 14.

23 *Cowan v Scargill* [1985] 1 Ch 270, 287; cited with approval in *Invensys*, above n 19. In respect of trust law generally, see *Tanti v Carlson* [1948] VLR 401; *Doneley v Doneley* [1998] 1 Qd R 602.

Other 'rules'

There are a number of other areas in which trust law supplies rules where the regulatory scheme is potentially otherwise silent. These include the rules derived from the doctrine of resulting trusts (most especially relevant where the division of a fund surplus is at issue)[24] and the rules relating to the review of the exercise of trustee discretions.[25] In both cases trust law can supply default rules to assist resolution of a particular dispute if the trust instrument and relevant statutory provisions are unable to effect such a resolution. They are not as visible as the rules that relate directly to the qualities of conduct expected of trustees, but they are important nonetheless.

To focus too closely on specific 'rules' found in trust law is however to risk misconceiving fundamentally the cognitive structure of equitable doctrine. Equitable doctrine, on which trust law is based, is woven from an array of interlocking principles.[26] Some of these principles find convenient expression in the famous 'Maxims' of equity,[27] but it would be a mistake to assume that the Maxims are anything more than summary statements of the underlying principles animating equitable doctrine.[28] Similarly, such positive 'rules' as emerge from equitable doctrine, are best understood as the result of the interaction of these underlying principles with diverse fact situations. As Viscount Radcliffe noted in *Commissioner of Stamp Duties v Livingston*

> Equity calls into existence and protects equitable rights and interests in property only where their recognition has been found to be required in order to give effect to its doctrines.'[29]

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24 See for instance *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399. Also Susan Traves, 'Superannuation Fund Surplus: Another problem for trustees' (1992) 1 *Griffith Law Review* 210; Richard Nobles, *Pensions Employment and the Law* (OUP, 1993), Ch 7.

25 *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36. See further Part 8.3 below.

26 I C F Spry, *The Principles of Equitable Remedies* (Law Book Company, 6th ed, 2001), 1.

27 For a description of the main Maxims, see R P Meagher, J D Heydon and M J Leeming, *Meagher, Gummow and Lehane's Equity Doctrine and Remedies* (Butterworths, 4th ed, 2002), Ch 3; Peter Young, Clyde Croft, Megan Smith, *On Equity* (LawBook Company, 2009), Ch 3.

28 Meagher et al, above n 27, [3-005]; Young et al, above n 27, 158.

29 [1965] AC 694, 712.

The rules that emerge in trust law are thus not the building blocks of doctrine but are rather manifestations of a more fundamental set of principles. As we shall see, this gives trust law an elasticity and an immediacy that is very valuable from a regulatory perspective. Equally, however, it exposes trust law to the charge of imprecision and results in other characteristics that, from a regulatory perspective, might be considered 'drawbacks'. Before proceeding too much further we should therefore clarify what we mean here by 'principle.'

The nature of 'principles'

It is widely recognised that the term 'principle' is used by the courts and by commentators in a variety of ways.[30] Dworkin for instance distinguishes between rules, which are highly prescriptive of the adjudicated outcome, and principles, which carry weight in, but do not determine, the adjudicated outcome.[31] In the hands of other theorists, principles are perceived to be simply less precise articulations of rules.[32] That connotation makes them synonymous with what other theorists might term 'standards'.[33] There is also the way in which the term 'principle' is employed in the literature relating to 'principles-based' regulation, one of the key paradigms in financial services regulation of the past decade. In that paradigm, a principle is typically less specific than a rule, but crucially is also more outcome-focussed than a rule. [34]

None of these descriptions adequately capture the role of principles in equitable doctrine. Equitable doctrine gains its valency from the value-based criterion of adjudication it will apply to the instant case. It is catalysed to intervene when there is an affront to one of its principles. Thus equitable doctrine, and hence trust law, is concerned to require qualities of conduct such as honesty, impartiality, fidelity, care and diligence from those identified as 'trustees'. Equity has little to say about the actual tasks required of a trustee; that is left

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30 William Twining and David Miers, *Doing things with rules* (CUP, 4th ed, 1999), Chapter 3.

31 Ronald Dworkin, *Taking Rights Seriously* (Duckworth, 1977).

32 Cristie Ford, 'Principles-Based Securities Regulation in the Wake of the Global Financial Crisis' (2010) 55 *McGill Law Journal* 54

33 Julia Black, '"Which Arrow?": Rule Type and Regulatory Policy', [1995] *Public Law* 94, 96.

34 Julia Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) 3(4) *Capital Markets Law Journal* 425, 432.

almost entirely to the trust instrument and to statute.[35] However equity is very concerned with how the trustee carries out its tasks. Crucially, though, as we have seen, the trustee's duty of care does not apply only in specific circumstances; it applies to all aspects of the administration of the trust. It will be engaged if the requisite standard of care is not met, irrespective of whether the task being undertaken by the trustee relates to the investment of trust assets,[36] the appointment of agents[37] or some other task properly undertaken by the trustee. So the role of the trustee is defined not only by specifying the tasks they are required to perform but also by specifiying the overarching qualities their conduct is expected to display whilst they perform those tasks.

In the context of this Thesis specifically, then, 'principles' can be thought of as those meta-connections within the regulatory scheme whose application is attracted not by specific circumstances but by some broader substantive concern.[38] An example similar to that often employed in the regulatory literature can be adapted to illustrate this conception. We can contrast the statement that 'drivers must not exceed 60kmh' with the statement that 'drivers must drive safely' and the statement that 'parents must attend to the safety of their children.' Only the last of these is a 'principle' in the typology proposed here. Though the first can be seen as a more specific articulation of the requirement to drive safely, the third applies beyond the activity of driving. It can apply to a wider range of situations than the other two statements, including some that may not have been anticipated at the time the statement was made. However, it is not simply a broader category than a 'standard.' The principle includes criteria of application that are not present in the first two examples. It adheres to the activity of driving because of the potential for that activity to bring about

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35 The main exceptions are obligations imposed by trust law that are supportive of the basic requirement to give effect to the trust, including the duty to get in trust assets, to become acquainted with the terms of the trust and to keep proper accounts: see J D Heydon and M J Leeming, *Jacobs Law of Trusts* (LexisNexis Butterworths, 7th ed, 2006), [1701], [1702] and [1713], and the cases cited therein, respectively.

36 *Cowan v Scargill*, above n 23; *Learoyd v Whiteley* (1887) 12 App Cas 727.

37 *Speight v Gaunt* (1883) 9 App Cas 1; *Robinson v Harkin* [1896] 2 Ch 415.

38 This is a conception of 'principles' that is similar to that articulated by Sunstein: Cass Sunstein, 'Problems with Rules' (1995) 83 *Californian Law Review* 956, 966.

something undesirable, in the same way that it might regulate the design of backyard swimming pools or the domestication of exotic pets.

The rationale for a principle is thus more evident than is usually the case in more narrowly expressed rules. This, along with the exhortative tone in which much equitable doctrine is articulated by the courts, goes some way to explaining why equitable doctrine is perceived by some as having a more deeply moral substance than other sources of law, a point to which we return in Chapters 7 and 8. The point to note here, though, is that the difference between statutory and regulatory rules and equitable principles is not simply one of specificity. Principles engage with the regulated activity on a different basis than rules, endowing them with an elasticity and immediacy that is of great regulatory value. It is to those strengths that we should now return.

6.2 The advantages of 'principles'

1. Elasticity

The first, and perhaps most potent, consequence of the trust law's reliance on principles is the elasticity it introduces into the regulatory system. Relying on principles rather than rules gives trust law the ability to address diverse circumstances. As Gummow J, has noted:

> The complex of values which ground equitable doctrines and remedies are an unfailing and inexhaustible source of guidance across new terrain.[39]

Moreover, as Spry notes, equitable principles are able to be applied directly to new circumstances.[40] In contrast, rules such as those found in the common law must operate by analogy when presented with novel situations. This means that unlike rules, which attach to a set of circumstances that are defined *ex ante*, principles can be applied to circumstances that were never anticipated. This flexibility is a powerful asset in a dynamic system, such as the superannuation system, in which entities and behaviours change continuously in response to, and sometimes even in anticipation of, regulatory constraints.

In the regulatory context, also, principles based on substance rather than form have certain advantages. They are, for instance, likely to be more effective when the activity being regulated is evolving swiftly or manifests in multifarious forms.[41] More pointedly, principles may also be more effective when competitive pressures encourage a regulatory dialectic between regulator and subject, such that a 'compliance' culture emerges in which the subjects seek to evade rather than respect regulatory rules.[42] Principles, in this context have the effect of transferring regulatory 'risk' from the regulator (who no longer needs to anticipate every outworking of a rule) to the regulated (who no longer has the comfort of specific rules to guide their decision-making).

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[39] William Gummow, 'Equity: Too Successful?' (2003) 77 *Australian Law Journal* 30, 42.

[40] Spry, above n 26, 1.

[41] Black ,above n 34, 432.

[42] Black, above n 34, 432-3, but cf 449-450.

Finally, it is worth noting that Equity's continued reference back to the context[43] in which the matter arises means that this process does not result in an homogenisation of regulatory standards. So for instance, although both trustees and company directors are fiduciaries, and are governed by many of the same principles, their responsibilities in respect of the duty of care, for instance, are distinct. As Part 5.3 noted, directors of a commercial enterprise are expected to exhibit a spirit of entrepreneurship that would be unacceptable in a trustee. This in turn means that the regulatory system can be calibrated in a more nuanced manner (that is, with regard to context and an accommodation of evolving practices) than would be possible with more rigid, tightly-defined rules.

2. Prominent substantivity

Equitable doctrine law famously employs many terms that have a powerful moral resonance.[44] Of course all law responds to some substantive imperative, but equitable doctrine wears its heart on its sleeve, as it were.

Trust law, as one manifestation of equitable doctrine, manifests this substantivity in no small degree. Terms such as 'trust', 'beneficiary', 'prudence' and 'bona fides' are imbued with a flavour that is designed specifically to inspire compliance. That is to say, the principles serve not simply to determine where the relative equities of the situation lie, but to communicate what is expected to the participants in the system. The notion that the articulation of equitable doctrine in terms of principles (rather than more neutral-appearing rules) gives trust law an exhortative effect that goes beyond simply the resolution of an instant case is the essence of the Normative aspect of trust law described in Chapter 7. It is introduced here because it is facilitated by the fact that equitable doctrine is formulated in the form of principles, but it will be discussed more fully in Chapter 7.

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[43] *Jenyns v Public Curator* (1953) 90 CLR 113, 119 (Dixon CJ, McTiernan and Kitto JJ).

[44] Gary Watt, *Equity Stirring. The Story of Justice Beyond Law* (Hart, 2009).

6.3 Drawbacks of Equity's reliance on principles

Equity's reliance specifically on 'principles' has some important implications for the use of trust law as a source of default rules in the regulatory regime shaping superannuation. Three drawbacks in particular are evaluated in the discussion below.

1. Imprecision

The most obvious downside of relying on principles to guide curial decision-making is that principles may appear to be, and in some cases are, less precise than rules. So for instance as Fullager J in *Blomley v Ryan* observed in relation to the court's jurisdiction to set aside a contract for unconscionability:

> when we look for the principle on which equity did grant relief in such cases, we find as so often in equity, only very wide general expressions to guide us.[45]

The inevitable tension between the desire to provide certainty on the one hand, and an orientation towards the merit of a particular case on the other, is one of the leitmotifs of equity jurisprudence. It has echoes at least as far back as the judgment of Lord Eldon in *Gee v Pritchard,* where his Lordship declared that:

> the doctrines of this Court ought to be as settled and as uniform, almost, as those of the common law, laying down fixed principles, but taking care that they are to be applied according to the circumstances of each case... Nothing would inflict on me greater pain, in quitting this place, than the recollection that I had done anything to justify the reproach that the equity of this Court varies like the Chancellor's foot.[46]

Not surprisingly, the appeal for certainty is heard most vociferously in the commercial context, where, to paraphrase the comment by Sir Anthony Mason reported in Part 5.2, men:

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[45] (1956) 99 CLR 362, 401.

[46] *Gee v Pritchard* (1818) 2 Swan 411, 414; 36 ER 670.

> constantly demand [a degree of certainty] from others [that they] rarely provide in their own arrangements.[47]

We will return to the role of Equity specifically in commercial contexts below.

The imprecision in equitable doctrine is not always due to its reliance on principles. Sometimes the imprecision arises from lexical imprecision in the judgments delivered by the courts.[48] An example of the way lexical infelicity can complicate matters was presented in Part 5.4 above, where Megarry V-C's protologistic duty of a trustee to act in the 'best interests' of beneficiaries in *Cowan v Scargill*[49] was discussed in the context of the s 52(2)(c) covenant.

It is also the case that the principles themselves have not always been comprehensively articulated. The debate around the nature and content of the fiduciary relationship, famously captured in Sir Anthony Mason description of the relationship as 'a concept in search of a principle'[50] is a prime example of this. The fact that such a search is deemed important (and has attracted such a volume of attention) is telling in itself. It underscores the basic point here; equitable doctrine propagates from the general to the specific. Fundamental principles underlie and hence inform and condition the 'rules' of equity with which fact situations come into contact.

Finally it should be noted that such imprecision as is identified in equitable doctrine may simply reflect either equity's attempt to get to grips with a novel fact situation, or an evolution in the principle itself. As Sir Anthony Mason has noted:

> The re-working by the courts of existing doctrine by reference to general concepts or traditional objectives presents ... [the difficulty] of articulating a reasonably precise and instructive principle from the general concept, with the risk that in the early stages of

47 Sir Anthony Mason, 'Themes and Prospects', Paul Finn (ed), *Essays in Equity* (LawBook Company, 1985), 243-4.

48 Spry, above n 26, 4.

49 [1985] Ch 270.

50 Mason, above n 47, 246.

> elaboration, the principle lacks definition and sharpness of focus, leading to some degree of uncertainty[51]

The pace of innovation in financial markets being what it is, the idea of an identifiable process of finetuning in which doctrine is considered, honed and re-worked may sound optimistic. It is particularly at odds with the purported 'barrenness' of equitable jurisprudence, to which we will return a little later.

2. Equity's limited ambition

We have noted on several occasions that equitable doctrine makes no claim to be comprehensive. To succeed at Equity, the claimed malfeasance must first be such as would inspire Equity to intervene.

There will be circumstances where equitable doctrine may simply not recognise the phenomenon to be regulated. A good example of this lack of recognition is the failure of trust law in Australia to require trustees to exercise the voting rights attached to the shares,[52] except potentially as an implied consequence of the duty to act in the best interests of members or where they have a controlling interest in the underlying company.[53] In the US, such voting rights are deemed to be property of the trust, and hence trustees are duty bound to 'manage' them.[54] In Australia voting rights are not characterised as property, and as such, are accorded a much lower level of protection than in the US.

At a deeper level, though, the silence of equitable doctrine on a various issues can be recognised as the product of its substantive concerns. Writing extra-curially, Lord Millett noted in respect of the pre-occupations and priorities of equitable doctrine that:

> equity insists on nobler and subtler qualities: loyalty, fidelity, integrity, respect for confidentiality, and the dis-interested discharge of obligations of trust and confidence. It extracts higher standards than those of the market place, where the end justifies the means

51 Ibid, 244.

52 Geof Stapledon, 'The Duties of Australian Institutional Investors in Relation to Corporate Governance' (1998) 26 *Australian Business Law Review* 331, 342-6.

53 *Re Lucking's Will Trusts* [1967] 3 All ER 726.

54 Stapledon, above n 52, 332-323.

> and the old virtues of loyalty, fidelity and responsibility are less admired than the idols of "success, self-interest, wealth, winning and not getting caught"[55]

The choice of trust law as the preferred legal architecture for superannuation funds implicitly endorses those qualities. Those are the qualities (if we assume Lord Millett has accurately and comprehensively listed them) in support of which Equity will intervene in default of statutory or other eclipse. Other qualities (and the imagination can quickly conjure up some contemporary examples: gender equity, environmental and social responsibility, economic efficiency, fame) do not receive direct support from equitable doctrine. That is not to say that they are directly opposed by equitable doctrine but rather to say that they are not represented in the pre-occupations, nor privileged in the priorities, of equitable doctrine. They will, as a result, be subordinated or eclipsed to the extent of their inconsistency when Equity intervenes, as we saw in the discussion of responsible (ESG) investing in Chapter 5.

Equity's preparedness to stand back unless catalysed by an affront to one or more of its principles is arguably benign within the confines of equitable jurisprudence. However it is potentially sources of concern where, as here, trust law is used as a source of default rules in a broader system. Ambivalence to the possibility of unrecognised (and hence unremedied) acts of malfeasance is a luxury that a regulatory scheme like that shaping superannuation can ill-afford. As such, it represents one cause for misgiving about the use of trust law in the 'default' role described in this Chapter. It is particularly a problem where, as we discuss in Chapter 7 and Part 8.3 below, the language of trust law inspires a protective aura around lay understandings of trusteeship. If, as the analysis in Part 8.3 suggests, trust law's protective qualities are more contingent and conditional than is usually appreciated, then trust law's value as a 'safety net' of default rules may be similarly compromised.

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55 Lord Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *Law Quarterly Review* 214, 216.

3. Overlap

Third, principles, unlike discrete rules, can and often do intersect in given fact situations. As Lord Scarman observed in the context of the equitable principles surrounding undue influence:

> this is the world of doctrine, not of neat and tidy rules.[56]

Unlike a mosaic in which each piece makes a unique contribution to the whole, equitable principles can overlap or intersect, sometimes inconsistently.[57] They may even point in different directions.[58] When this happens, conformity with one principle does not supply a defence to the contravention of another. So for instance in *National Trustee Co v General Finance Company*[59], the honesty of the trustee was no defence to the breach of trust occasioned by mis-payment by the trustee.

Some have argued that this is because there is no overarching jurisprudential superstructure that organises and binds the principles.[60] Others are less certain,[61] and some are intent on imposing one.[62] It is beyond the scope of this Thesis to try to resolve this, but some insight can be derived from an alternative metaphor offered by Heydon, Gummow and Austin, who observe:

56 *National Westminster Bank Plc v Morgan* [1985] AC 686, 710.

57 Spry, above n 26, 6; Sir Anthony Mason, above n 47, 244.

58 William Gummow, 'Conclusion,' in Simone Degeling and James Edelman, *Equity in Commercial Law*, (Lawbook, 2005), 515.

59 (1905) AC 373.

60 R P Meagher, J D Heydon and M J Leeming, *Meagher, Gummow and Lehane's Equity Doctrine and Remedies* (Butterworths, 4th ed, 2002), [1-010].

61 For a discussion of the contention that there is emerging in Australian law a consensus around the idea that equitable principle springs from a desire to remedy unconscionable conduct, see Patricia Loughlan, 'The historical role of the equitable jurisdiction' in Patrick Parkinson (ed), *The Principles of Equity*, (Lawbook Company, 2003).

62 For an ambitious programme attempting to impose a self-consistent typology on the law relating to obligations, see the work of Birks, summarised in Peter Birks, 'The content of fiduciary obligation' (2002) 16 *Trust Law International* 34.

> equity forms a unity rather than merely a scattered collection of glosses on the common law; that now as much as in its early days it is reducible to certain fundamental principles ...and that the best judges exhibit, in their handling of equity more than most legal subjects, a consciousness of this seamless web.[63]

The notion of a web of intersecting principles, one or more of which may apply to any given situation, and between which there are regions untouched, is sufficient here. It highlights that there are likely to be important connections between the principles without necessarily requiring that those principles be explicable or justified by reference to any coherent and/or cohesive overarching programme.

The challenge posed by this overlap is not insurmountable, but nor is it trivial. The subjects of regulation need simply to understand that the rules deriving from equitable doctrine are cumulative; that it is not enough to be honest, or impartial, that one has to be careful also.

4. Two red herrings

Before we conclude this Part on the shortcomings of trust in law in respect of a 'default' role in the regulatory scheme we need to address briefly two features of equitable doctrine that might appear on first blush to be further shortcomings. As we shall see, closer examination substantially dispels this concern.

Equity's purported 'barrenness'

Sir Anthony Mason's description of a process of doctrinal finetuning implies a generative (or perhaps re-generative) facility within equitable doctrine. However there is a very real question whether the set of equitable principles is now closed. Or to use the oft-quoted but perhaps apocryphal words of one commentator, there is a question whether equity has lost its capacity for 'childbearing.'[64]

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63 JD Heydon, WMC Gummow and RP Austin, *Cases and Materials on Equity* (Butterworths, 1st ed, 1975), at v.

64 Though traditionally attributed to Harman J by (then) Robert Megarry in (1951) 67 *Law Quarterly Review* 505, 506, the actual source of this metaphor is unclear; see Sir Raymond Evershed, 'Equity is not presumed to be past the age of child-bearing' (1954) 1 *Sydney Law Review* 1. The phrase was eventually given curial imprimatur by Evershed LJ in *Simpsons*

Speculating on this is of course hazardous.[65] Rossiter and Stone writing in 1988, for instance, detected a 'renewed vigour' in Australian equity jurisprudence,[66] though their thesis was more directed towards whether the High Court of Australia was rolling back the formalism of Lord Eldon in favour of a more conscience-driven reliance on principles than whether new principles had been developed and applied.[67]

The attempts by Lord Denning, in particular, to broaden the application of equitable doctrine, or even to create new equitable principles, have been progressively eroded.[68] Some have chosen to respond to the challenge to create a 'New Equity' issued by Lord Denning in 1952[69] by extending the metaphor. So for instance Bagnall J in *Cowcher* v *Cowcher opined* that:

> This does not mean that equity is past childbearing; simply that its progeny must be legitimate — by precedent out of principle.[70]

Motor Sales (London) Ltd v *Hendon Corporation*[1964] AC 1088 and later by Lord Denning MR in *Eves* v *Eves* [1975] 1 WLR 1338.

65 As Young J, writing extra-curially recently wrote, in response to a similar question

> The best answer I can give to this question is, "I don't know." I have looked at various twentieth century articles on "Whither Equity?" and their lack of prediction of what did in fact occur makes me shy from the task.

Peter W Young, 'Equity, Contract and Conscience' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Lawbook, 2005), 512.

66 Christopher Rossiter, and Margaret Stone, 'The Chancellor's New Shoe' (1988) 11(1) *UNSW Law Journal* 11, 23.

67 Ibid, 24.

68 In particular Lord Denning MR's attempts to extend the application of the constructive trust (see for instance *Binions v. Evans* [1972] 2 All ER 70, 75-77) have been met with withering opposition. See also the comments of Lord Scarman in the House of Lords in *National Westminster v Morgan*, in respect of Lord Denning's assertion that a principle relating to an "inequality of bargaining power" underlies the doctrine of undue influence; *National Westminster Bank Plc v Morgan* [1985] AC 686, 708A.

69 A Denning, 'The Need for a New Equity' (1952) 5 *Current Legal Problems* 1, 2.

70 [1972] 1 WLR 425, 430.

However such statements mask an immanent conservatism, for as Sir Anthony Mason has suggested in relation to the stagnation of Equity jurisprudence in the first half of the twentieth century,

> precedent became an attitude of mind as much as legal doctrine ...[and] the sterility of this approach became apparent.[71]

Whether the reliance on precedent that has characterised equitable jurisprudence since the start of the nineteenth century has permanently sterilised Equity's ability to generate genuinely new doctrine remains to be seen. It is certainly true, for instance, that some of Equity's recent initiatives have become part of the accepted landscape. Prominent amongst these are the 'Mareva' injunction,[72] 'Anton Piller' orders,[73] Quitclose trusts[74] and Romalpa clauses.[75] Notably, though, these developments are more in the character of new applications of existing principles than new principles themselves.[76] They may simply be 'old wine in new bottles,' to employ a metaphor suggested by Lobban.[77] As such they may simply be a further illustration of the ability of Equity's principles-based approach to adapt to new circumstances. Or, as Lord Eldon himself phrased it almost two hundred years ago in the segment of his judgment in *Gee v Pritchard* that was reproduced more fully above:

71 Mason, above n 47, 242.

72 Named after *Mareva Campania Naviera SA v International Bulk Carriers SA* [1975] 2 Lloyd's Rep 509.

73 Named after *Anton Piller KG v Manufacturing Processes Limited* [1976] Ch 55 but in fact first used by courts of first instance in the preceding eighteen months, including Templeman J in *EMI Limited v Pandit* [1975] 1 All ER 418.

74 Named after *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

75 Named after *Aluminium Industrie Vaassen BV v Romalpa Alumnium Ltd* [1976] 1 WLR 676.

76 *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298 per Mason P, 328. Also Hon. Justice WMC Gummow, 'Equity: Too Successful?' (2003) 77 *Australian Law Journal* 30.

77 Michael Lobban, 'Old wine in new bottles': the concept and practice of law reform c1780-1830' in Arthur Burns and Joanna Innes (eds), *Rethinking the age of reform: Britain, 1780-1850* (CUP, 2003).

> the doctrines of this Court ought to be as well settled and as uniform, almost as those of the common law, laying down fixed principles, but taking care that they are to be applied according to the circumstances of each case.[78]

Equity's purported disinclination to regulate commercial dealings

Finally it is necessary to respond to the suggestion that there is a pervasive curial disinclination to complicate commercial dealings by the superimposition of equitable rules that were not in the contemplation of the parties.[79] As Keane J, citing *Perre v Apand Pty Ltd*[80] colourfully concluded:

> Equity never set out to bring to heel what John Maynard Keynes described as "the uncontrollable and disobedient psychology of the business world[81]

There is no doubt that superannuation trusts have a commercial dimension. They are embedded in various ways in employment and industrial relations and in financial markets.[82] As we saw in Chapter 1, the larger funds are considerable commercial entities in their own rights, employing a sizeable workforce, offering multiple services to 'members' and engaging in sophisticated commercial transactions for administering the fund and investing its assets.

The argument in this Thesis to this point has engaged with this purported disinclination tangentially on a number of occasions. At the very most basic level, the Thesis has relied on Megarry V-C's finding in *Cowan v Scargill* that he could find:

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78 *Gee v Pritchard* (1818) 2 Swan 411 at 414; 36 ER 670.

79 Lindley LJ's judgment in *Manchester Trust v Furness* [1895] 2 QB 539 at 545 is often cited in this regard but dicta to similar effect can also be found in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 119, (Wilson J) and 149-150 (Dawson J); *New Zealand and Australian Land Co v Watson* (1881) 7 QBD 374, per Bramwell LJ, 382. But cf. Ciro and Goldwasser who describe an emerging trend in Australia towards curial intervention in defining acceptable business conduct; Tony Ciro and Vivien Goldwasser, 'From Private law to Public Regulation: A New Role for Courts?' (2003) 15 *Bond Law Review* 154.

80 (1999) 198 CLR 180, 299.

81 P A Keane, 'The Conscience of Equity' (2010) 84 *Australian Law Journal* 92, 111.

82 *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36, 246.

> no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts [83]

From this starting point, as we saw in Chapter 4, the courts have had regard for the 'matrix of fact' surrounding the trust relationship in construing the provisions of the deed. This purposive approach to construing the trust instrument threatens to attract precisely the constraints described so colourfully by Keane J above. It suggests that the commercial nature of the superannuation relationship might stay Equity's hand, discouraging the courts from intervening to adjust the balance of equities.

In fact the opposite has been the case. The courts have regularly attempted to give recognition to the employment context, in particular, in which superannuation and pension arrangements arise. The dicta of Bryson J in particular[84] evince a desire (sometimes thwarted) to give effect to the expectations that a member might reasonably form *qua* employee. Similarly, the High Court in *Finch*[85] was at pains to emphasise the importance of superannuation both to the individual member and to the Australian economy and society as a whole. Neither perspective suggests a disinclination to involve the court in superannuation matters.

There are two possible ways to square this inclination with the disinclination referred to by Keane J. It might be that, as Lord Justice Millett contends,[86] whatever disinclination might have once resided in the breasts of equity jurisprudes is waning.[87] However a more

83 [1985] 1 Ch 270, 290. In Australia, see *Fouche v The Superannuation Fund Board* [1952] 88 CLR 609; *Locke v Westpac* (1991) 25 NSWLR 593. See also Gummow J's *obiter* muse on whether construction of a superannuation trust deed required any 'special' approach, such as that proposed in some UK cases; *Caboche v Ramsay* (1993) 119 ALR 215, 233. The implication of the comment, though it is admittedly ambiguous, is that no special approach is required.

84 See discussion in Chapter 2 accompanying nn 41 - 42.

85 Above n 82.

86 Lord Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *Law Quarterly Review* 214.

87 Also *Hospital Products v USSC* (1984) 156 CLR 41, 100 (Mason J).

compelling possibility is offered by Priestley JA in *Walker v Corboy*.[88] In that case his Honour offers the opinion that:

> It seems to me to be prudent not to approach the question whether equitable doctrines are applicable in a commercial situation with the thought in mind that one should be disinclined to give a positive answer to the question. The question simply is, do the particular circumstances attract equitable rules. There is no reason to regret one answer rather than the other.[89]

It will be readily apparent that this approach emphasises the 'particular' circumstances of the matter. Those circumstances will necessarily include the employment relation and other 'commercial' considerations, in the superannuation context, but there is no reason to expect any overriding inclination or disinclination to intervene.

88 (1990) 19 NSWLR 382.

89 *Walker v Corboy* (1990) 19 NSWLR 382, 386. Clarke JA appears to concur with this view, at 390.

Concluding Comments

A regulatory scheme that aspires to encompass the range of activities and entities present in the Australian superannuation system, and to do so for a timeframe that extends over many decades, faces significant challenges. It must be flexible enough to accommodate the diversity of regulated subjects and yet precise enough to enable the individuals subject to regulation to understand what it expects of them and to permit remediation where those expectations are not met. And it cannot hope to anticipate and address every development in the system, particularly where the commercial and financial markets pressures provide a relentless evolutionary impulse, so it must have access to a 'safety net' of rules.

This chapter has demonstrated how equitable doctrine, through the modality of 'principles', provides a (limited) safety net that can apply in situations where either statute or private negotiation are deficient. There are limits to trust law's preparedness to do this that relate to the cognitive structure of Equity, in particular the fact that it will supply content to the regulatory scheme by intervening only in those circumstances where catalysed by a failure by the regulatory scheme to secure compliance with one or more equitable principles. It is not a source of law that purports to be comprehensive in the sense of providing resolution in all situations. However Parliament must be taken to have recognised this limited sphere of engagement and to have implicitly accepted that imposition of the 'nobler' qualities on participants in the system was a desirable addition to the substantive effect of the regulatory scheme.

Chapter 7

Trust law's normative role

'That there have not been scandals of an equal dimension to that perpetrated on Maxwell-owned pension funds owes more to the decency of employers and the integrity of trustees than to trust law'

Social Services Select Committee (UK)[1]

The contributions made by trust law to the regulatory scheme identified in Chapters 4, 5 and 6 occur within the formal legal system. They influence the way in which the courts deliberate on the appropriate allocation of accountability in the situations that come before them. The contribution described in this Chapter is of a different nature. This Chapter investigates the possibility that trust law's influence extends beyond the formal operation of the legal system; that it permeates the consciousness of participants in the system and thereby creates norms that influence their behaviour.

It would be premature to assert that trust law unequivocally does have such an effect in the superannuation system. The extent to which 'trustee' norms actually influence the behaviour and decisions of individuals acting on the trustee boards of superannuation funds has never been adequately mapped empirically. This Thesis does not aspire to fill that gap. However, there are reasons to suppose that the way in which trust law is articulated does influence the self perceptions of the individuals acting on the trustee boards of superannuation funds. In starting here to identify evidence of such influences, it is hoped that the analysis might act as a catalyst for future research.

Part 7.1 briefly introduces the idea that citizens comply with the law for reasons that go beyond a simple fear of legal or regulatory sanction. Issues of reputation and

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1 House of Commons Select Committee on Social Security, *The Operation of Pension Funds*, Second Report (1992).

acculturation are also important. Part 7.2 then argues that the court's use of evocative language in articulating trust law is specifically designed to engage these additional motivations. It argues that the language is deliberately employed by the courts to inspire a set of distinctive behavioural norms in an audience that includes, but crucially extends beyond, the parties before the court. In the superannuation context, these 'trustee' norms reinforce the substance of the more formal legal contributions made by trust law discussed in Chapters 4, 5 and 6. Part 7.3 concludes with a discussion of the research on the culture of superannuation and pension fund trusteeship, and in particular investigates whether that research contains evidence of those shared and individual norms in the beliefs and practices of trustee boards.

7.1 Normativity, compliance and 'law-abidingness'

It is widely recognised that the words used by the courts in delivering judgment have a resonance beyond the individual circumstances of the matter before the court and beyond the role the dicta may play as precedent in subsequent matters.[2] In using terms such as 'duties', obligations,' 'rights,' and 'wrongs' the language is intended to do more than simply communicate the outcome of a particular dispute. It has, and indeed is often intended to have, a normative effect in the sense of telling 'citizens how they ought to behave'.[3]

The language employed by the courts thus sends signals to the wider audience about how the legal system views different types of behaviour by different types of actors in different circumstances. It articulates the criteria for decision applied to the instant case. It also implicitly betrays the pre-occupations and priorities underlying those criteria. This is important because the self-recursiveness of the legal system means that the audience can rely on the substantive effect of those messages being 'stable'.[4] So trustees and their advisers can observe, and extrapolate and interpolate, from the outcomes of the (small number of) cases relating to superannuation and to trusteeship generally. They can observe the way the court has chosen to express its reasons in those cases and draw inferences about how the courts and regulators might react to a hypothetical set of circumstances in the future. They can then modify their behaviour accordingly, confident that the same processes of adjudication, modes of reasoning, and criteria and principles will apply to them.[5]

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2 Simon Gardner, 'Two Maxims of Equity' (1995) 54(1) *Cambridge Law Journal* 60, 60.

3 Stephen A Smith 'The Normativity of Private Law', (2011) 31(2) *Oxford Journal of Legal Studies* 215, 215.

4 Niklas Luhman, 'Law as a Social System', (1989) 83 *Northwestern University Law Review*, 136, 140.

5 Whether they choose to comply, or engage in a cost-benefit calculus analogous to that suggested by Lord Diplock in *Moschi v Lep Air Services Ltd* [1973] AC 331 (to perform or to pay damages) in relation to performance of contractual obligations, is another matter.

It is important not to over-simplify this deliberative process however. Sociologists have found that fear of detection and punishment by the state is just one of three basic motivations for individuals to abide by the law.[6] Also salient are the fear of damage to one's reputation and the desire to act in accordance with one's internal ethical/moral precepts. We will investigate these motivations in Parts 7.2 and 7.3, after first considering the role of formal sanctions in the superannuation context in a little more detail.

Fear of sanction in the superannuation context

There are no doubt contexts in which the fear of detection and punishment is a powerful motivator. For reasons outlined below, it is very doubtful if serving on the trustee board of a superannuation fund is one of them.

We have already commented in other contexts on the comparative scarcity of case-law related to the governance of superannuation funds by trustees.[7] Very few of the superannuation cases discussed in this Thesis have related to trustee misconduct of a type likely to be influenced by a calculus in which the prospect of personal gain is weighed against the threat of sanction. The overwhelming majority of cases that have come before the courts in respect of large scale superannuation funds have involved either the distribution of a surplus,[8] a question in which the propriety of the trustee is seldom an issue, or else rather narrow issues related to members' rights to TPD

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6 Robert A Kagan, Neil Guningham and Dorothy Thornton, 'Fear, duty and regulatory compliance: lessons from three research projects' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance. Business Responses to Regulation* (Edward Elgar, 2011), 41.

7 See Introduction, above.

8 See for instance *Lock v Westpac* (1991) 25 NSWLR 593; *Invensys v Austrac Investments* (2006) 198 FLR 302, and in the UK, *Re Courage Group Pension Scheme* [1987] 1 All ER 528; *Imperial Group Pension Trust v Imperial Tobacco* [1991] 2 All ER 597; *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32; *Hillsdown Holdings plc v Pensions Ombudsman* [1992] 1 All ER 862.

benefits.[9] Cases such as *ASC v AS Nominees*[10] and *Cowan v Scargill*[11] in which the conduct of trustees is specifically scrutinised by the court, are few and far between. The observation that can be distilled from that sparse case law is that, absent actual personal fraud (as for instance in the Maxwell scandal in the UK), court-enforced accountability for individuals serving on the trustee boards of superannuation and pension funds is rare.[12]

Of course not all state action in the superannuation system occurs through the courts. There is also the potential for regulatory intervention by APRA. However as we saw in Chapter 1, APRA employs a regulatory stance in respect of superannuation funds that favours constructive remediation where possible rather than direct sanction.[13] This is borne out by empirical analysis of APRA's regulatory activity in the superannuation system. Table 1 below documents the frequency of different forms of enforcement activity by APRA in relation to superannuation entities over the past six years.[14] (The bracketed numbers report the portion of APRA's total use of that type of action that pertained to superannuation entities.)

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9 *Vidovic v Email Superannuation* (Unreported, Supreme Court of New South Wales, Bryson J, 3 March 1995); *Telstra Super Pty Ltd v Flegeltaub* (2000) VSC 107; *Sayseng v Kellogg Superannuation* [2003] NSWSC 945; *Tuftevski v Total Risks Management Pty Ltd* [2009] NSWSC 315; *Finch v Telstra* [2010] HCA 36.

10 (1995) 133 ALR 1.

11 [1985] Ch 270.

12 One example where there was an attempt to impose individual accountability, albeit a proceeding in the Administrative Appeals Tribunal was *Re VBN and APRA* [2006] AATA 710 which was discussed in detail in Chapter 5.

13 Julia Black, 'The development of risk-based regulation in financial services: just 'modelling through'?' in Julia Black, M. Lodge and Mark Thatcher (eds), *Regulatory Innovation: A Comparative Analysis* (Edward Elgar, 2005), 156.

14 The data are derived from APRA's *Annual Reports* for 2006, 2008 and 2010; available at www.apra.gov.au.

Table 1

Enforcement Action	2005		2006		2007		2008		2009		2010	
	#	%	#	%	#	%	#	%	#	%	#	%
AAT/FCA review	7	(41)	13	(81)	1	(14)	1	(9)	1	(17)	-	
Appointment of acting trustee	3	(100)	1	(100)	11	(100)	2	(100)	38	(100)	5	(100)
Appointment of liquidator	2	(67)	-		-		19	(100)	-		5	(33)
Civil litigation	13	(100)	3	(43)	3	(25)	1	(100)	-		2	(67)
Directions/contraventions notice	403	(89)	2	(20)	4	(19)	132	(65)	81	(79)	91	(55)
Disqualification of auditors/directors	17	(43)	22	(61)	7	(44)	2	(25)	n/a		n/a	
Enforceable undertakings	2	(67)	164	(99)	-		2	(100)	3	(100)	-	
Investigation	36	(61)	7	(64)	4	(50)	24	(100)	23	(100)	5	(10)
Prosecution	7	(100)	-		2	(67)	1	(100)	n/a		n/a	
Refer to other agency/police	36	(63)	9	(60)	6	(46)	12	(52)	6	(67)	10	(45)
Removal of trustee	-		1	(25)	-		-		2	(100)	1	(100)
Show cause letter	26	(35)	52	(84)	11	(85)	49	(96)	1	(100)	1	(100)
Other	7		17		44		91		109		109	
Total	559	(75)	291	(80)	93	(58)	336	(75)	264	(66)	229	(53)

The Table highlights that the incidence of formal enforcement action by APRA in the superannuation system is very low. There are several spikes obvious in the data presented, such as the issuance of contraventions notices and directions in 2005 and enforceable undertakings in 2006, and the appointment of acting trustees in 2009, but on the whole formal enforcement action by APRA in the superannuation system has been infrequent when the size of the regulated population is considered.

It is important to bear in mind that the fear of detection and punishment is likely to be a function not just of the likelihood of detection and punishment (both of which appear to be low in the superannuation system) but also the severity of the sanction that would apply to a transgressor. Again, though, the recent history of the superannuation system suggests that transgressors seldom, except in the most egregious cases, face significant financial penalties or incarceration. Indeed the threat of disqualification from acting as a director, seen for instance in *re VBN*,[15] would appear to be as much about the reputational effect of the order (on which more below) as it is about imposing a financial penalty on the transgressor.

15 Above n 12.

Other motivations for compliance by members of trustee boards

Compliance with the regulatory system is no doubt somewhat motivated by the fear of detection and punishment, even in the superannuation system. However the remoteness of threat of formal sanction suggested by the analysis above suggests that reputational risk aversion and a process of acculturation that inspires internal norms are important also.

This is where trust law's 'normative' role comes in. It is argued in Part 7.2 that trust law does not simply define accountabilities and provide criteria that can be applied to the circumstances before them by courts, tribunals and regulators. Trust law, it is argued, deliberately aspires to influence trustee behaviour. Specifically, the courts use highly-charged language infused with a connection to morality to inspire norms of trusteeship. Moreover these exhortations operate at two levels. They operate at an individual level by causing individuals to assess their actions and intentions against their personal moral code, the assumption being that an individual's moral code is likely to be more exacting and more difficult to ignore than externally imposed constraints on behaviours, such as formal legal rules. The exhortations also operate at a social level. Transgressions against shared norms represent an affront to the ties that define and bind the community of peers within the system. Transgressions against these shared norms can therefore be expected to have a very pronounced negative effect on the reputation and social acceptance of the individual involved. In catalysing these effects, the normativity of trust law thus complements the more formal elements of the regulatory scheme. It also contributes to the creation and maintenance of a distinctive culture of trusteeship in Australia's superannuation system.

7.2 The 'normativity' of trust law

The normativity of private law is especially evident in equitable doctrine. As we shall see, judgments of the court often contain metaphors of such colour and language of such stridency that it is clear that the words employed are intended to serve a purpose beyond simply communicating the outcome of the instant case. There is often no reason for the courts (and expert bodies such as the Law Reform Committee) to recycle the colourful language to the extent they do, if the intent is merely to dispassionately communicate either the substantive effect of the principles applied or the outcome of the dispute.

The obvious conclusion to be drawn from this phenomenon is that the language is intended not only to communicate and explain the judgment of the court, but to seek a connection with the audience that is not simply literal and rational, but also emotive and normative. This more visceral quality of connection might reasonably be expected to promote compliance with the rules so articulated not just by those on whom judgment has been delivered. It might also be expected to influence parties beyond those involved in the matter before the court to whom the courts' statements and attitudes are reported.

It is also possible that as Watt, quoting White, notes, such language:

> expands one's sympathy, it complicates one's sense of oneself and the world, it humiliates the instrumentally calculating forms of reason so dominant in our culture.[16]

Equitable doctrine, then, does not simply act as a substantive counterbalance to what Lord Millet described as 'the idols of "success, self-interest, wealth, winning and not getting caught"'; it in many cases changes the register of deliberation from one of cost versus benefit to one that involves social and personal considerations. The language employed by the courts does not simply re-weight the calculus; it disrupts and unsettles

[16] Gary Watt, *Equity Stirring. The Story of Justice Beyond Law* (Hart Publishing, 2009), 86.

the whole process of rational calculation and catalyses the social and internal motivations for compliance with the law described by Kagan et al.[17]

A punctilio (sic) by way of example

Perhaps the best example of the influence that the colourful rhetorical garb in which fiduciary discourse is often clothed is the frequent reference to Justice Cardozo's colourful description of a 'punctilio of an honor most sensitive' in the US case *Meinhard v Salmon*.[18] 'Punctilio' is hardly a part of the contemporary lexicon,[19] and yet the phrase is quoted repeatedly in both legal[20] and lay sources.[21] For instance, in the US, where Justice Cardozo's dictum has value as precedent, Hillman has traced curial citation of both *Meinhard v Salmon* and the quote excerpted above, finding that the phrase appears in over 40% of the 1000+ US state and federal cases citing *Meinhard*.[22] And, as Powell notes:

> Judges and lawyers who cite *Beatty* [another rhetoric-laden judgment of Cardozo J] and *Meinhard* seldom discuss or even mention the facts in either case ... Cardozo's influence

17 Above n 6.

18 *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928), 546.

19 Indeed, although the word can be found in most forms of the Oxford dictionary, only two examples of its use in the comprehensive 2nd Edition of the OED come from the twentieth century (one by John Updike, the other a publication of the Royal Air Force). One comes from the nineteenth. The other examples all date from the eighteenth and seventeenth centuries. An exception must however be made for Jeffries JA of the Queensland Court of Appeal who found an opportunity to employ the word in *EPAS v AMP General Insurance* [2007] QCA 212, [15].

20 In Australia see for instance *Russell Fraser Henderson v Amadio* (1995) 140 ALR 391 and *Thomas v Smp International (No 4)* [2010] NSWSC 984, [70], the latter noting that the phrase is 'high-flown by today's standards.'

21 See for instance Rosemary Teele, 'The Search for a Fiduciary Principle: A Rescue Operation' (1996) 24 *Australian Business Law Review* 110, 112; Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 *Law Quarterly Review* 452.

22 Robert W Hillman, 'Closely-held firms and the common law of fiduciary duty: what explains the enduring quality of a punctilio' (2006) 41 *Tulsa Law Review* 441.

> in this area lies not in the holdings of the court for which he spoke, but in the language he used[23]

Likewise the more subdued, but nevertheless metaphorical, reference by Cardozo J in the same case to the fiduciary standard as:

> a higher level than that trodden by the crowd[24]

is regularly re-cycled by the courts[25] and by commentators.[26] The phrase even found its way into the 1992 Law Reform Commission report into Superannuation.[27]

This is not mere theatricality on the part of commentators and the courts. O'Connor neatly summarises the impact of Cardozo's description, and fiduciary discourse generally:

> an appreciation of the literary dimension of fiduciary discourse allows us to understand better its pedagogic character. Cardozo's language offers much more than details adding to one's stock of information; it seeks to penetrate everyday life by appealing to our ears and hearts, and offers an experience, an invitation for reflection. Cardozo's memorable words encourage readers to internalize the message, to change their way of thinking and being. That is, the cognitive aspect of fiduciary law operates through

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23 Jefferson Powell, 'Cardozo's Foot: The Chancellor's Conscience and Constructive Trusts' (1993) 56(3) *Law and Contemporary Problems* 7, 16.

24 Above n 18, 546.

25 See for instance *Warman International v Dwyer* (1995) 128 ALR 201, 209, cited with approval in *Harris v Digital Pulse* (2003) 56 NSWLR 298, 330 (Mason P).

26 See for instance Matthew Conaglen, *Fiduciary Duty. Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010), 106; Deborah De Mott, 'Fiduciary Obligation under Intellectual Siege: Contemporary Challenges to the Duty to be Loyal' (1992) 30(2) *Osgoode Hall Law Journal* 471; Anthony Duggan, 'Contracts, fiduciaries and the primacy of the deal' in Elise Bant and Matthew Harding (eds), *Exploring Private Law* (CUP, 2011). Also Gino Dal Pont, *Equity and Trusts in Australia* (LawBook Company, 5th ed, 2011) 99; Roderick Meagher, Dyson Heydon and Mark Leeming, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (Butterworths, 4th ed, 2002), [2-315]; Peter Young, Clyde Croft and Megan L Smith, *On Equity* (Law Book, 2009), [7.270].

27 Australian Law Reform Commission, *Collective Investments: Superannuation*, Report No 59 (1992).

> musical language seeking to inspire us to rise above our own self-interests by arousing our imaginations and emotions. This sermon-like style captivates our moral consciousness and contributes to an understanding of fiduciary obligation in ways that reason alone cannot. The poetic language sensitizes us by surrounding the word "fiduciary" with a mesmerizing aura that strongly identifies it with the morality of duty.[28]

That is to say, the court's wider audience is apparently charmed by the description's archaism almost as much as they are encouraged by the high standards of selflessness the description appears to demand. This, despite fairly wide agreement that the rhetorical value of Cardozo's formulation outstrips its practical value as a judicial principle[29] and the fact that it has limited value as a precedent for an Australian court. The memorability of the phrase and its evocative effect give it a power, and a utility for the regulatory scheme, beyond that which a more prosaic description could command.

The relevance of the moral element

The language employed by the courts in respect of trust is often not only vivid, it is often charged with a moral undertone.[30] The use in equitable doctrine of morally-charged terms such as 'conscience,' 'vulnerability,' 'trust' and 'good faith,' creates this impression even if those terms do not always connote in equitable doctrine what they appear to connote in lay usage.[31] But the invocation of morality is, sometimes, of an even more direct nature. So for instance, in explaining the prohibition on fiduciaries placing themselves in a position where their duty to their principal would conflict with

28 Marleen O'Connor, 'How Should We Talk About Fiduciary Duty? Directors' Conflict-of-Interest Transactions and the ALI's Principles of Corporate Governance' (1993) 61 *George Washington Law Review* 954, 967.

29 John Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *Yale Law Journal* 625, 658.

30 Watt, above n 16.

31 In respect of the 'conscience' of Equity, see Christopher Rossiter, and Margaret Stone, 'The Chancellor's New Shoe' (1988) 11(1) *UNSW Law Journal* 11; Mike MacNair, 'Equity and Conscience' (2007) 27 (4) *Oxford Journal of Legal Studies* 659; Paul Vinogradoff, 'Reason and Conscience in Sixteenth Century Jurisprudence' (1908) 24 *Law Quarterly Review* 373.

their personal interests or duties to another would conflict, Lord Cairns LC said in *Parker v McKenna:*

> Now, the rule of this Court, as I understand it, as to agents, is not a technical or arbitrary rule. It is a rule founded upon the highest and truest principles of morality[32]

Similar statements recur frequently in judgments in the equitable jurisdiction.[33]

This is not to say that equitable doctrine is founded in morality. As Conaglen in particular has shown, equitable doctrine may join paths with morality in certain circumstances and may employ moralistic language, but fiduciary doctrine, including where it intersects with trust law, is:

> cynical, functional and instrumentalist in outlook.[34]

Rather, it is argued here, the appeal to morality in the court's articulation of equitable doctrine adds a further layer to the emotional appeal of the language. It implies that breach of a fiduciary obligation carries the threat not just of legal sanction but also moral opprobrium. As O'Connor concludes:

> Thus, fiduciary discourse has a complex psychological appeal that speaks to our better side to desire noble aspirations, while simultaneously reprimanding our other side by instilling fear of fiduciary breach.[35]

Writers in other, analogous fields have started to develop this theme further. Johnston, for instance, writing primarily about US corporate law, points to the:

> normatively saturated and judgmental language that, in tone and words, resemble sermons and parables[36]

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32 (1874) LR 10 Ch 96, 118.

33 Conaglen, above n 26.

34 Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 *Law Quarterly Review* 452, 454

35 Above n 28, 968.

36 Lyman Johnston, 'Counter-Narrative in Corporate Law: Saints and Sinners, Apostles and Epistles' (2009) *Michigan State Law Review* 847, 850.

He identifies a 'master narrative' in US corporate law that permits business actors substantial freedom to pursue their self-interest. The fiduciary discourse in the courts of equity acts as a 'counter-narrative' to this dominant master narrative. The counter narrative, he argues, imposes a measure of self-restraint and, in so doing inspires a 'moral drama'. Johnson's concern, however, is not with the morality *per se*. It is that the exhortative effect of the counter-narrative is diluted in the re-telling by the legal profession (the' elite corporate bar', as he terms it), and so the 'sermon' reaches its intended audience only in diluted form and is thus rendered less effective. His concern therefore is that the reduced effectiveness of the counter-narrative in moderating pursuit of the master narrative will inspire the state to intervene directly. He concludes that only if the counter-narrative is fully retold to business actors in its full glory can the state continue to permit unfettered pursuit of the master narrative.

Brennan[37] and Black,[38] each from rather different perspectives, are similarly animated by the role that the legal profession plays in the transmission of principles from the formal parts of the legal system to its intended lay audience. Brennan, writing extra-curially, advocates that lawyers ensure that they acquaint their clients with the 'moral dimension' of the issues they face, as well as the strictly legal ones.[39] Black, like O'Connor, is concerned with the possibility that the professional predilections of lawyers may distort the message in the regulatory signals intended for their clients; that by the application of their 'lawyerly' modes of interpretation, analysis and expression, the message may be transformed into something different from what the regulator originally intended.[40] The colourful, morally-charged language used and re-cycled by the courts is perhaps one way in which the courts try to ensure that their underlying

37 Sir Gerard Brennan, 'Commercial Law and Morality' (1989) 17 *Melbourne University Law Review* 100, 105.

38 Julia Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) 3(4) *Capital Markets Law Journal* 425.

39 Brennan, above n 37, 105.

40 Black, above n 38, 447.

message of their judgment is not lost to its lay audience within the technical complexities of legal rules and procedure by which that judgment is given effect.

An Anglo-Australian perspective

There is little doubt that modern Anglo-Australian trust lawyers pale in comparison to their predecessors and to their US brethren in respect of their evangelical rhetoric.[41] As James LJ noted in *Re Adansonia Fibre Company v Miles' Claim:*

> I think in these prosaic days, and in the old age of the court, we do not indulge in those flights of imagination which our predecessors did.[42]

The judgments delivered by modern courts are for the most part more precise, deliberate and concrete, as well as being more staid in their choice of metaphors.

That said, there are parts of Megarry V-C's judgment in *Cowan v Scargill*[43] that echo the moral censure so evident in the early cases. So for instance consider the tone of the following:

> No doubt some trustees with strong feelings find it irksome to be forced to submerge those feelings and genuinely put the interests of the beneficiaries first. Indeed, there are some who are temperamentally unsuited to being trustees, and are more fitted for campaigning for changes in the law. This, of course, they are free to do; but if they choose to become trustees they must accept it that the rules of equity will bind them in all that they do as trustees. [44]

Another example is his Lordship's observation that:

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41 See for instance Roebuck's capitulation to 'duller' metaphors; David Roebuck, 'Insights into Equity' (2003) 15 *Bond Law Review* 24.

42 (1873-4) LR 9 Ch App 635, 644.

43 Above n 11.

44 Ibid, 293.

> Honesty and sincerity are not the same as prudence and reasonableness. *Some of the most sincere people are the most unreasonable*; and Mr. Scargill told me that he had met quite a few of them. (emphasis added). [45]

This can be contrasted with the reserve with which Ralph Gibson, Leggatt and Hoffman LJJ of the UK Court of Appeal delivered their judgment in *Bishopsgate v Maxwell.*[46] Despite an acute awareness of the magnitude and consequences of the fraud perpetrated on the Mirror group pension funds in that case, the court refrained from the admonishing tone found in *Cowan v Scargill,* even when directing its comments to the family members of the late Robert Maxwell, perpetrator of the fraud.

Australian jurists have also not been completely immune to the seductive appeal of the rhetoric. The reference to Cardozo J's formulation in the Law Reform Commission's Report has already been noted[47] as has the High Court's reference to Cardozo's dicta in *Warman International v Dwyer.*[48] However in the other key passages of that latter judgment,[49] the language bears the more circumspect and dignified tone more commonly found in modern Australian cases involving fiduciary obligations.

A similarly sober tone is maintained throughout the judgments delivered in the landmark case in Australia on the nature and scope of fiduciary relationships, *Hospital Products v US Surgical Corporation*[50] as well by Waddell CJ in Equity in the Supreme Court of NSW in *Lock v Westpac Banking Corporation.*[51] Indeed the overwhelming impression gained from the review of cases in the equitable jurisdiction on which this Thesis is based is that (with a few exceptions) modern Australian courts have preferred to let the rhetoric of their predecessors speak for them, recognising that the respect for

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45 Ibid, 289.

46 [1994] 1 All ER 261.

47 See above n 27.

48 See above n 25.

49 Ibid, 213.

50 *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41, 67-74 (Gibbs CJ), 96-100 (Mason J) and 147 (Dawson J).

51 (1991) 25 NSWLR 593.

precedent inculcated in Equity since the time of Lord Nottingham will ensure that those powerful statements echo in modern corridors. Today, it would seem that when, as Mason P noted in *Harris v Digital Pulse*

> 'equity readily trumpets its punitive/deterrent intent'[52]

it does so in the design and imposition of stringent remedies, such as an account of profits, or the disallowance of 'just allowances', rather than newly minted rhetorical devices or especially purple prose.

Normativity and 'prophylaxis'

One final comment is required before we discuss the resonance between the rhetoric characterising and defining the trustee role and the culture of trusteeship found in the superannuation system. That is to distinguish the normative effect described here from the so-called 'prophylactic' rules found within equitable doctrine.[53] Both seek to influence behaviour, but the prophylaxis described by Conaglen et al operates within the bounds of the legal system whereas the normative modality described in this Chapter operates in addition to the formal legal system.

That of course is not to deny the reflexion between this normative role and the formal legal system. The potential for legal sanction is clearly one factor contributing to the social and internal motivations in the sense that the presence of the legal and regulatory sanctions reinforces the anti-social quality of the conduct impugned. However it is the potential for uncomfortable dissonance with internal and societal norms that galvanises these other motivations, not the imposition of a legal sanction.

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52 (2003) 56 NSWLR 298, 330-333, in dissent unrelated to this excerpt.

53 See for instance Conaglen, above n 26; Peter Birks, 'The Content of Fiduciary Obligation' (2000) 34 *Israel Law Review* 3. Conventional wisdom links the heavy-handed deterrence inherent in the prophylactic rules advanced by the court in the eighteenth and nineteenth centuries to the circumstances of the Chancellor's court at that time. See for instance Lord Eldon in *ex p. Lacey* (1802) 6 Ves Jun 686; 31 ER 1228. But cf the UK Court of Appeal in *Murad v Al-Saraj* [2005] WTLR 1573CA (CivDiv), where the court regarded that argument as anachronistic, preferring to emphasise instead the effect of the stridency in shifting the onus of proof to the defendant trustee.

Part 7.3 The inspiration of 'trustee' norms

Chapter 1 noted that the office of 'trustee' is constituted by the intersection of specific rules (or 'meta-connections'). It noted that the rules contribute the substantive content that gives the term 'trustee' meaning. Parts 7.1 and 7.2 argued that the exhortative language used in trust law provides an important part of this. The language inspires a set of 'trustee' norms that go beyond the enforcement mechanisms present in the formal legal system; that the stridency of, and undertone of moral approbation in, the courts' language contributes to the creation of a culture of trusteeship in which collegiality and selflessness is the norm. The question addressed here is whether there is any evidence of such shared beliefs amongst the members of trustee boards of Australian superannuation funds?

There are several grounds for suggesting that the rhetoric surrounding trust law does indeed inspire 'trustee' norms. Three are discussed below.

The Trustee Ethic

The first ground for suggesting that the normativity of trust law contributes to the culture of trusteeship in the superannuation system is the high regard held by lay commentators, practitioners and policy makers for notions like 'fiduciary' and 'trust' that is readily discerned in superannuation industry publications, websites and the like.[54] The industry appears to take the rhetoric very seriously indeed. Moreover, the lay connotations of these phrases seems to extend beyond their strict legal meanings, in

54 See for instance Sally Patten, 'Try gamification to beat disruption,' *Australian Financial Review*, 18 June 2012, 1; John Ingram, 'Industry funds not union playthings,' *Australian Financial Review*, 1 May 2012, 63; Duncan Hughes, 'High fees at retail super funds', *Australian Financial Review*, 13 July 2010, 48; Peter Weekes, 'Good deeds and super returns', *Sunday Age*, 17 February 2008, 22; 'Setting a new agenda,' *Super Review*, 1 October 2007.

many cases extrapolating the 'desirable' features of those notions in pursuit of the norms of selflessness and industriousness that they believe underpin trusteeship.[55]

Do trustees actually believe (and act upon) the rhetoric? Unfortunately there has been little formal research specifically into the attitudes of trustees with respect to their own roles. Newitt, in her unpublished research into the governance of superannuation funds, found that trustees expressed very strong preference for statements inclining towards a member-oriented culture over statements betraying a more self-serving orientation.[56] So for instance when asked to rank-order statements relating to their motivation in joining their board, 'I believe the superannuation industry is crucial for Australia's future, and I have a contribution to make' ranked first, and 'I want to help ordinary people enjoy their retirement' ranked second, ahead of 'my skill set and experience lend themselves to working as a super fund trustee' (third), 'my sponsoring organisation needed to nominate someone and they felt I was the best person'(fourth), 'I enjoy working with finance and investments' (last).[57] Similarly, trustees strongly endorsed the statement that 'Trustee Directors are highly motivated and committed to advancing member interests.' They also believed that their boards handled conflicts of interest well.[58] These statements align with the requirements of diligence and member orientation inherent in traditional conceptions of trusteeship.

Such findings have, of course, to be interpreted with some caution. The experimental design forced the identification of preferences across prepared responses, and the

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[55] This proclivity to be over-optimistic about the protections afforded by Equity may not be unique to lay discourse in the superannuation context. As Lord Radcliffe noted in *Bridge v Campbell Discount Co:*

> equity lawyers are, I notice, sometimes both surprised and discomfited by the plenitude of jurisdiction, and the imprecision of rules that are attributed to 'equity' by their more enthusiastic colleagues.

[1962] AC 600, 626.

[56] Shey Newitt, 'What drives superannuation trustee board performance?' (Paper presented at AIST Fund Governance Conference, Melbourne, May 2009).

[57] Ibid, 14.

[58] Ibid, 15.

actual subjective motivation of the individuals may have lain outside the options provided. Perhaps more perniciously, there is at least the possibility that the answers provided reflect what the individuals thought were the 'politically correct' responses and not their real motivations. Even in that case, though, the result says something intelligible about the 'culture' of the cohort; the subjects of the research had a common understanding of what they were 'supposed to say.'

A Compliance Culture

Another ground for suggesting that those serving on trustee boards exhibit a culture inspired by the rhetoric of trust law is the presence of a 'compliance' culture amongst superannuation trustees.[59] Sir Anthony Mason is but one observer who has noted that the superannuation industry, within which rubric he was including fund trustees, has acquired a culture of 'compliance'.[60] Research undertaken by APRA confirms this impression.[61] Funds surveyed in 2008 indicated that despite compliance being accorded by far the lowest priority (relative to nine other tasks), almost 25% of trustee time was employed 'ensuring compliance with legislation and regulation.' This was almost twice the time taken 'reviewing and assessing the fund's investment performance,' and approximately three times the time taken on other key tasks.

One interpretation of this data is that trustees feel themselves exposed to an array of rules with which they must comply or risk sanction. This would be consistent with Black's contention[62] that regulatory schemes that are highly detailed promote a 'compliance' culture in which broader principles (such as those inherent in being a

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59 Notably, the term 'compliance culture' is used by commentators in both a positive sense (to connote an awareness of legal rules) and a negative sense (to connote a pre-occupation with the strict letter of the law). The term is used here in the latter sense.

60 Sir Anthony Mason, 'Superannuation and Conflicts of Interest' (Paper presented at Law Council of Australia Superannuation Conference, February 2005).

61 APRA, 'Superannuation fund governance: Trustee policies and practices' (2008) *Insight*, 9-10. Note these observations are based on the sector-weighted averages of the data presented in the tables on those pages.

62 Black, above n 38, at 432-3.

fiduciary) are lost. Against this, though, as we have seen, the threat of formal sanction for breach of their duties is remote. Moreover, superannuation funds are not subject to scrutiny of the intensity visited on publicly-listed corporations by securities analysts, investment managers, hedge funds, the ASX and by lenders such as banks. So information that might give rise to identification of a breach of either trust law or the statutory rules typically stays within a close circle encompassing the superannuation fund, its service providers and, to a limited extent, APRA and ASIC.

An alternative explanation that deserves further research is that the rhetoric surrounding trusteeship has the effect of sensitising individuals to the seriousness of the role of trustee, and that their risk-mitigating response is to seek compliance with the rules they can identify. The availability and apparent precision of the statutory rules brings them to the fore, while the apparently amorphous and aspirational equitable principles provide the background, the tenor that characterises the trustee role.[63] The rhetoric, then, inspires conformity with the rules without necessarily informing the audience of the nuances in substantive content of the less-concrete set of principles that actually constitute trust law.

Institutional influences

Finally, regard should be had for the possibility that the institutional context in which the members of trustee boards make decisions itself influences those decisions.

There can be no doubt that trusteeship of a major superannuation fund carries with it a level of prestige in certain circles, most particularly the union movement. It is associated with the notion of public service and wealth preservation, and rather less with entrepreneurship and wealth creation (which might be thought to permeate corporate board membership in other contexts). Moreover, once an individual becomes

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63 This effect is perhaps reinforced by the asymmetrical pay-off faced by members of trustee boards. The negative effect on individual reputations from the publicity surrounding an official sanction, whether by APRA or the courts, dramatically outweighs any benefits that could reasonably be expected to accrue to those individuals from 'sailing close to the wind' as it were.

a member of a trustee board there are no doubt strong informal forces encouraging conformity with peer expectations, similar to those experienced by members of other commercial[64] and not-for-profit boards.[65]

Research specific to the decision-making of Australian superannuation fund trustees that would support or qualify this intuitively plausible conclusion is sparse. In other jurisdictions however, there is compelling evidence that trustee board members are not the context-independent rationalists assumed in the standard economic literature.[66] This is consistent with the wider literature that recognises that both individual[67] and group[68] decision-making routinely departs from the 'rational' calculus assumed in neo-classical economic theory. But there is more being suggested here than simply incompetent or 'irrational' behaviour. Here it is suggested that the context in which those individuals find themselves generates (to a limited extent) and sustains (to a large extent) extra-legal norms which taken together, might be described as a 'culture' of

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64 See for instance in respect of directors specifically thepioneering work of Myles Mace, *Directors: Myth and Reality* (Harvard University Press, 1971), 186-188. More recently see Donald Langevoort, 'The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability' (2001) 89 *Georgetown Law Journal* 797.

65 For a recent account of the literature relating to the dynamics of governing boards in the non-profit sector, see Gavin Nicholson, Cameron Newton and Myles McGregor-Lowndes 'The Nonprofit Board as a Team: Pilot Results and Initial Insights' (2012) 22(4) *Nonprofit Management and Leadership* 461.

66 See for instance Gordon Clark, 'Why convention dominates pension fund trustee investment decision-making' (1998) 30 *Environment and Planning* 997; 'Governing finance: reconciling functional imperatives with stakeholder representation in financial institutions' (2008) 84 *Economic Geography* 281.

67 See for instance Daniel Kahneman, 'A psychological perspective on economics' (2003) 93 *American Economic Review* 2.

68 See for instance Min Gong, Jonathan Baron and Howard Kunreuther, 'Group cooperation under uncertainty' (2009) 39 *Journal of Risk and Uncertainty* 251. The literature on group decision-making is summarised in Matthias Sutter, 'Individual Behavior and Group Membership: Comment' (2009) 99 *American Economic Review* 2247.

superannuation fund trusteeship. That culture represents an alternate rationality for decision-making. That rationality has its own logic and is thus predictable and explicable even if it not economically 'rational.'

The idea of acculturation in the pension fund world is hardly new. Conley and O'Barr's anthropological study into the behaviour of individuals working in the pensions industry in the US analysed a range of behaviours and beliefs displayed by individuals within the organisations they studied.[69] They found norms of behaviour and belief that were so embedded in the cultures of the organisations and the industry within which the individuals worked that the individuals were not conscious of their existence. Nevertheless the norms were of paramount performance in guiding decision-making. The misconceptions even extended to their interpretation of the legal requirements (mostly under ERISA) applying to them. As Conley and O'Barr noted:

> Pension fund executives shape their conduct according to strongly held, but often highly idiosyncratic, understandings of the law's dictates.[70]

Later they elaborated:

> At each of the nine funds we studied, all of the upper-echelon employees were well-versed in the rhetoric of the law. We heard repeatedly that everything they did was in the interests of their beneficiaries, ... but knowledge of the law's rhetoric is of little help to pension executives who must decide just how to pursue the beneficiaries' interests[71]

They went on to note that (in respect of social investing specifically, but relevant more generally):

> What emerges... is a picture of fund executives continually re-creating the law in their own image and likeness to support the judgments they make on contentious issues.[72]

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69 William M O'Barr and John M Conley, *Fortune and Folly. The Wealth and Power of Institutional Investing*, (Business One Irwin, 1992).

70 Ibid, 97.

71 Ibid, 101.

72 Ibid, 120. Edelman and Talesh argue that this approach to defining regulatory obligations extends more generally; Lauren Edelman and Shauhin Talesh, 'To comply or

Thus, in place of rationality, the subjects of Conley and O'Barr's study brought to their questions cultural 'baggage' informed by a desire to manage the attribution of responsibility and blame, an inertia unconsciously imposed by the shared historical experience of their organisation and a concern about the maintenance of social relations within the immediate environs of the organisation. Formal rationality was replaced by information heuristics and context-dependent decision-making of a type under-estimated until recently in economic theory.

Might a similar dynamic be at play in the cadre of individuals serving on trustee boards in Australia? Although intuitively such a conclusion seems plausible, and is supported by anecdotal evidence, again there is little empirical research available to answer this question. Gupta et al, for instance, analysed the responses to a survey of the attitudes of 131 individuals serving on the boards of 54 superannuation funds. They concluded that:

> The picture that emerges from the analysis is one of a rather contented group of individuals who dislike formality and regulation and share a common set of beliefs.[73]

That picture is consistent with Newitt's findings on board collegiality, which she found to be strong.[74] Beyond those two incomplete glimpses into the issue, however, there is to date no research in Australia that addresses the extent to which the sorts of institutional practices and norms identified by O'Barr and Conley are present in the Australian system.

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not to comply – that isn't the question: how organisations construct the meaning of compliance' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance. Business Responses to Regulation* (Edward Elgar, 2011), 103.

73 Vrinda Gupta, Henry Jin, Michael Orszag and John Piggott, 'How do Australian Superannuation Trustees Perceive Their Role and Effectiveness' in John Evans, Michael Orszag and John Piggott (eds), *Pension Fund Governance. A Global Perspective on Financial Regulation* (Edward Elgar, 2008).

74 Although she declined to record a conclusion on this issue in her written report she did make colourful, but unattributable, comments verbally along these lines when presenting her findings to the conference organised by the sponsor of her research, the Australian Institute of Superannuation Trustees, (5 May 2009, Melbourne).

Finally a word of caution is required. Conley and O'Barr were very critical of the practices and norms they identified in their research on the grounds that those practices and norms represented a departure from rational decision-making. It would be premature to arrive at such a conclusion in the case under consideration here. Conley and O'Barr attracted considerable criticism from the pensions industry when they published their results, in part because they were unable to connect the acculturated decision-making to poor investment performance.[75] In contrast, the norms of diligence and single-minded pursuit of members' interests posited above for the Australian case would, if pursued, act as positive reinforcement of the regulatory objectives. So to say that trustee decision-making may be influenced by its institutional context is not necessarily to say that it is inappropriate, merely that it is influenced by norms that correlate with, but are not identical to, trustees' formal legal responsibilities.

75 Some flavour of this can be seen in the review of *Fortune and Folly* appearing in the *Financial Analysts Journal* (November/December, 1992), 87.

Concluding Comments

The striking language employed in trust law is no accident. It is clearly intended to do more than simply announce the decision of the court. It has been argued here that the exhortations are intended to inspire trustees to demonstrate qualities of service above those required in other settings. Moreover, by engaging with social and internal norms, the language of trust law aims to employ modes of influence that operate outside the formal operation of the legal system. This is the 'normative' contribution made by trust law to the regulatory scheme. The contours of this contribution have but yet to be mapped precisely empirically but there are good reasons to believe that this aspect of trust law's role has contributed at least to some extent to the substance of the culture of 'trusteeship' that has developed in the superannuation system over the past two decades.

Chapter 8

Trust law's role in promoting the regulatory objectives

'the community now has a considerable reliance on and interest in prudent management of superannuation fund] assets. Poor investment decisions, or fraudulent conduct of funds, can result in significant losses for affected members'

Productivity Commission[1]

The superannuation system owes its existence to public policy. It owes much of its current shape to the regulatory scheme to which it is subject.

As we have seen, trust law plays an integral role in that regulatory scheme. It contributes substantive content to the regulatory scheme in four ways. Those modalities were identified in Chapter 3 as trust law's infrastructure, interpretive, default and normative roles. They were analysed in detail in Chapters 4 to 7. Importantly, however, although those chapters emphasised the instrumental dimension of trust law's contribution, they inevitably also provided examples of the substantive contribution made by trust law. In particular, they provided illustrations of the impact trust law has on the allocation of responsibility across the system. That conditional allocation of responsibility, the 'matrix' of accountability, is the essence of the substantive contribution made by trust law.

This Chapter addresses the substantive contribution of trust law specifically from the perspective of the two regulatory objectives identified in Chapter 2. It assesses the

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1 *Review of the Superannuation Industry* (2001), xvii.

contribution made by trust law to the promotion of economic efficiency and member protection.

Part 8.1 briefly reprises the relationship between the regulatory objectives and the ‘substance’ of the regulatory scheme.

Part 8.2 then assesses the ways in which trust law promotes the achievement of the objective of economic efficiency. It concludes that trust law’s private law nature gives it attributes and generates outcomes that neo-classical economists would argue are supportive of economic efficiency. Most importantly, trust law is capable of accommodating private market modalities which discipline the processes and institutional structures that constitute the superannuation system. In this sense it can be said to offer limited support for the objective of economic efficiency.

Part 8.3 then assesses the extent to which trust law promotes the achievement of the objective of member protection in the superannuation context. It concludes that trust law effects an allocation of risk and responsibility that contributes integrally to the regulatory scheme’s objective of protecting members. However that contribution is more nuanced and conditional than might be inferred from the overarching paternalism apparent in the language in which trust law is often expressed. It is also contingent on the terms of the trust instrument and on statute. Nevertheless it is clear that policy makers have harnessed aspects of the substance of trust law in the regulatory scheme to promote achievement of the member protection objective.

This Chapter thus rounds out the analytical portion of this Thesis. It establishes that trust law is intertwined in the regulatory scheme in a way that is more complex than is usually recognised. It demonstrates that trust law not only contributes to the fabric of the regulatory scheme by providing an infrastructure, a language and, in some cases specific rules and norms to that scheme, but that trust law’s substantive pre-occupations and priorities are relevant to, and in some ways promote, the achievement of the regulatory objectives.

8.1 The regulatory objectives and the substance of the regulatory scheme

Chapter 2 identified two regulatory objectives underlying the regulatory scheme: economic efficiency and member protection. The two objectives are not mutually incompatible but they do compete at the margin.

The regulatory objectives are important because they provide criteria to guide the calibration of the regulatory scheme. As we saw in Chapter 2, the regulatory scheme re-distributes accountability amongst participants in the system. It determines in which circumstances parties who have suffered loss can seek to have the burden of that loss remediated by some other party. The matrix of accountability that results from the interplay of the various rules determines the substance of the regulatory scheme: it determines where accountability lies in different circumstances, and with what consequences? The regulatory objectives, then, provide high level criteria for determining and justifying the allocation of accountability across the system.

Trust law, of course, is only one component of the regulatory scheme. It is merely one strand in the inter-legal regulatory tapestry. As we have seen in Chapters 3 to 7, the various strands are inter-dependent, relying on each other both instrumentally and substantively. Trust law relies on statute, and statute on trust law. Contract is also important, as is administrative action by the regulator. Therefore far from carrying the burden of promoting the regulatory objectives itself, it is trust law's ability to contribute to the achievement of the objectives, directly or indirectly in combination with those other strands, that is important. It is against this backdrop that the role of trust law in respect of the regulatory objectives must be assessed.

Part 8.2 Trust law and economic efficiency in the superannuation system

The economic efficiency of different systems of rules has received a great deal of attention from commentators. Their attention is typically directed towards whether the object of their analysis (such as a system of rules) leads to an outcome that approximates that which would issue from an algorithm tasked with computing an optimal 'efficient' solution.[2]

The approach in this Part shares certain sympathies with such theoretical enterprises. It is concerned with identifying elements of trust law which promote the economic efficiency of the superannuation system. It does not however attempt to demonstrate that trust law's presence in the system actually causes the system to achieve economic optimality. Nor does it attempt to map comprehensively the effect of every aspect of trust law in terms of economic efficiency.

Accommodating private market modalities

The starting point is to recognise that Australia's superannuation system is administered largely by individuals and firms in the private sector. It is subject to and critically relies on market forces to condition individual and organisational behaviour in the system. This is not necessarily a problem from a regulatory perspective. Indeed market forces can be expected to motivate many of the participants in highly predictable directions, some of which may be consistent with the regulatory objectives.

Private market modalities are, then, pervasive across the superannuation system. Several examples have been encountered already in this Thesis. Three will be discussed

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2 Perhaps the most influential example is Richard Posner, *Economic Analysis of Law* (Aspen, 8th ed, 2011). Closer to the specific subject matter of this Thesis, see Anthony Ogus, 'The Trust as a Governance Structure' (1986) 36 *University of Toronto Law Journal* 186; Anthony Duggan, 'Is Equity Efficient?' (1997) 113 *Law Quarterly Review* 601.

specifically here; the reliance on competition to promote efficiency and innovation, the value to the system of distributing decision-making, and the privileging of individual choice in the system. Trust law accommodates each of these private market modalities to some extent, and in so doing contributes to the promotion of economic efficiency within the system.

Competition, market structure and innovation

Adam Smith's 'invisible hand'[3] of competition is perhaps the most important modality of neo-classical economics. It is the process that resolves the contest of individuals for scarce resources. It imposes what is sometimes called 'market discipline'[4] on the system and its participants. Self-interested competition on the part of participants impels the system towards an equilibrium in which the decision criteria (most notably price, but also product definition) are set at a level at which the quantities demanded by buyers match the quantities sellers are prepared to offer. This same process brings about an institutional structure supportive of that market-clearing outcome; inefficient suppliers leave the market, firms merge or take the shape optimally suited to delivering the level and nature of the product(s), and they each invest in research and development to allow them to innovate for new products that will enable them to compete more potently in the future.[5]

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3 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (reprinted Liberty Classics, 1981), book IV, chapter II. For an elementary description see Paul Samuelson, *Economics* (McGraw Hill, 2nd Australian Edition, 1973), 58 – 60.

4 In the superannuation (pensions) context, see Paul Brigden and Traute Meyer, 'The Politics of Occupational Pension Reform in Britain and the Netherlands: the Power of Market Discipline in Liberal and Corporatist Regimes' (2009) 32(3) *West European Politics* 586.

5 Samuelson, above n 3, 517-520.

Trust law has little to say about competition directly. Indeed, as the comments of Lord Millett quoted in Chapter 6[6] highlighted, the values inherent in trust law are sometimes seen as a potential counterbalance to the pursuit of economic self-interest that underlies the dynamic of competition.

Equally, though, trust law's private law origins accommodate competition, albeit only in certain respects and with certain limitations. The processes of industry growth and rationalisation described in Chapter 1 are a good example of this. It is clear that the use of trust law as the legal infrastructure for the 'product' has contributed to comparatively low barriers to entry and innovation in the industry,[7] notwithstanding a regulatory scheme that in its totality is usually regarded as very complex. This in turn has permitted the evolution of market structure described in Chapter 1. On the other hand it is arguable that trust law actually hinders product rationalisation. This is because trust law's concern for the welfare of individual members makes it very hard to close or merge funds, even where they are obsolete, inefficient or uncompetitive.[8]

Similarly, as we saw in Chapter 4, trust law generally imposes few constraints on the way in which a trust instrument is drafted.[9] The terms of the trust must be capable of

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6 See n 55 in Chapter 6; Lord Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *Law Quarterly Review* 214, 216.

7 Productivity Commission, *Review of the Superannuation Industry* (2001).

8 The main reasons for this were outlined in Commonwealth of Australia, *Product Rationalisation,* Issues Paper (2007), 13 – 15. The government is currently considering a variety of measures to alleviate this constraint. See Government's Response to Recommendations 10.9 and 10.10 in Commonwealth of Australia, *Stronger Super* (2010), available at www.strongersuper.treasury.gov.au

9 There are of course other requirements related to the substantive content of the trust. None, it turns out, are relevant to the superannuation context. So for instance the trust law rule that the terms of the trust should not promote conduct that is either illegal or contrary to public policy; *Thrupp v Collett (No.1)* (1858) 26 Beav 125; 53 ER 844; *Fender v St John-Mildmay* [1938] AC 1; *Trustees of Church Property of the Diocese of Newcastle v Ebbeck* (1960) 104 CLR 394 is rendered irrelevant by s 62, the sole purpose test

an interpretation that renders the subject matter and objects of the trust certain[10] but there are few other formal requirements.[11] The *SIS Act* takes a similar approach. It intervenes only in respect of a finite set of matters, such as the qualities of service expected of the trustee,[12] restrictions on clauses relating to trustee indemnities[13] and the requirement that the trustee be a constitutional corporation.[14]

One result of this *laissez faire* approach[15] is that trust instruments can be drafted in ways that facilitate innovation in the form of new product developments. There is a myriad of local examples but it is not necessary to rely on local observation to see this effect; it can be seen even in the summary descriptions of the system provided in Chapter 1, which operated at the highest levels of generality. There it was noted that a single trust instrument can support schemes structured as defined benefit or defined contribution or a conditional hybrid, or even a mix of the three, depending on the requirements (and often history) of the contributing employer or financial institution.[16] Similarly, deeds establishing so-called 'master trusts' have been developed by some participants to permit a differentiation of responsibilities that facilitate a transfer of

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described in Part 5.5. Similarly, the rules against perpetuities found in most common law jurisdictions is held not apply to superannuation trusts by s 343 of the *SIS Act*.

10 See J D Heydon and M J Leeming, *Jacobs Law of Trusts* (LexisNexis Butterworths, 7th ed, 2006, Chapter 5 and the cases cited therein.

11 Ibid.

12 For example the covenants imposed by s 52 of the *SIS Act*. These were described and analysed in Parts 2.2, 5.3 and 5.4.

13 *SIS Act,* s 56.

14 *SIS Act*, s 19. The alternative, seldom used, is that the governing rules must provide that the sole or primary purpose of the fund is the provision of old-age pensions.

15 This description is not used lightly. Rossiter and Stone argue persuasively that important aspects of equitable doctrine derive from the philosophical milieu surrounding the formalisation of equitable doctrine by Lord Eldon in the early nineteenth century; Christopher Rossiter, and Margaret Stone, 'The Chancellor's New Shoe' (1988) 11(1) *UNSW Law Journal* 11, 15.

16 See Part 1.2 above.

certain responsibilities from employer to specialist third party trustee companies, and in so doing create a whole new industry sector.[17] The trust form is flexible enough to enable these and other innovations whilst retaining the basic features (segregated asset ownership, member protection, and so on) on which regulators and policy makers rely.

If trust law is not directly concerned with competition, it does inject into the system a dynamic that has a very similar effect. That arises by virtue of the requirement that trustees act in the best interests of members. The analysis in Part 5.4 demonstrated that this requirement, now enshrined in the covenant imposed by s 52 (2)(c), catalyses trustees to seek an optimal solution (without necessarily holding them accountable if it turns out, *ex post*, that the strategy chosen was not the most favourable available).

There are three ways in which this requirement promotes efficiency.

Most obviously, as we saw in Chapter 2, the costs incurred by funds are one important aspect of the efficiency of the system. At the very least, the requirement in s 52 (2) (c), as informed by trust law in the ways described in Part 5.4, would seem to require trustees who are negotiating fee and service level agreements with the agents of the trustee identified in Chapter 1 to negotiate hard on behalf of members to secure the best deal they can.

More subtly, though, the requirement that trustees have regard for the unique needs of the members of the fund, their 'best interests', creates a dynamic in the system by which the granular needs of members are represented in the marketplace. This means that although members may not be empowered (or indeed inclined) to exercise consumer sovereignty on their own account, the trustees of the funds of which they are members are seeking to advance their interests in the markets, encouraging demand-satisfying innovation on the part of other participants and disciplining inefficiency in ways similar to those present when consumers act directly. Thus here again trust law is

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17 See Part 1.4 above.

acting to encourage conduct on the part of trustees the effect of which is to create market dynamics that promote economic efficiency.

Finally, the limitation that trustees must have regard for the members' financial best interests, narrowly defined by trust law to be those connected with the fund,[18] and the requirement that trustees exercise their powers of investment for a proper purpose[19] has the effect of emulating the criteria that neo-classical economics would deem as 'rational'. In this sense, again, trust law can be seen to accommodate, and partly promote, the market dynamics that are central to neo-classical models of economic efficiency.

De-centralised decision-making by trustees on behalf of members

Another feature of Australia's superannuation system that has attracted attention is its widely de-centralised nature.[20] Key investment decisions are taken by trustees independently on behalf of members in funds across the country.

There are grounds for concern that such a 'delegation' may seem risky and inefficient from a systemic perspective. There is little guarantee that the trustees will make good decisions.[21] Indeed the government has repeatedly had to resist calls for it to direct trustees how to invest.[22]

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18 *Cowan v Scargill* [1985] 1 Ch 270.

19 Ibid. Also *Harries v Church Commissioners for England* [1992] WLR 1241.

20 See for instance Ian Robinson, 'Superannuation – a policy perspective' in Ken Davis and Ian Harper *Superannuation and the Australian Financial System* (eds), (Allen & Unwin 1992) 8, 13; Hazel Bateman and Susan Thorp, 'Decentralized investment management: an analysis of non-profit pension funds' (2007) 6 J*ournal of Pension Economics and Finance* 21.

21 Bateman and Thorpe, above n 18.

22 See for instance, Dawkins, *Strengthening Super Security* (1992), 13.

There is also a strong likelihood of systemic redundancy, with trustees going through elaborate and expensive processes to make similar decisions.[23] There may also be a failure to exploit the potential for economies of scale to deliver efficiencies both to individuals and the system as a whole. Recent calls for a single national 'default fund' to administer the superannuation accounts of those members who have not expressly chosen a particular fund are largely motivated by these concerns.[24]

Trust law responds to this only partially. Firstly, trust law's presence directly regulates the actions of the key decision-makers (trustees) at a distance from the regulatory 'centre'. In crude terms by imposing certain duties on trustees it aims to promote better decision making at a local, fund level. In addition, trust law's presence also has two effects with an indirect bearing on the problem. It provides a credible alternative to direct government intervention, which enables the government to distance itself from accountability for the investment success of the system and (arguably) reduces the risk of governments introducing efficiency-reducing distortions to address political pressures.[25] Finally, in accommodating de-centralised decision-making, trust law also contributes to the stability of the system as a whole, which has an inherent value that regulatory theory is only now starting to recognise. Each of these contributions is worth further examination.

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23 Adam Clements and Michael Drew, 'Institutional Homogeneity and Choice in Superannuation' (2004) 17 *Accounting Research Journal* 102; Gerry Gallery, Natalie Gallery and Lyn McDougall, 'Don't Judge a Superannuation Default Investment Option by its Name' (2010) 20 *Australian Accounting Review* 286; Wilson Sy, 'Towards a national default option for low-cost superannuation'(2009) 22(1) *Accounting Research Journal* 46.

24 See for instance Sy, above n 23.

25 As to which, see Robinson, above n 18, 14; Hazel Bateman, Geoffrey Kingston and John Piggott, *Forced Saving. Mandating Private Retirement Incomes,* (CUP, 2001), 1.

Trust law and 'better' decision-making

In the neo-classical economic models that have guided policy making in superannuation, the more closely that trustees conform to rational decision-making, especially in the exercise of their investment power, the more likely that the superannuation system's impact on the process of capital accumulation in the economy will promote economic efficiency.[26] However trust law does not directly impose 'rationality' on trustees. Nor, as we saw in Part 5.3, does it impose competence standards on trustees.

That however is not the end of the matter. Trust law does require trustees to act carefully and the standard of care that is expected is calibrated by reference to the prudent business person.[27] The prudent business person might reasonably be expected, if not to act rationally, then at least to have regard for modern investment technologies which themselves manifest 'rational' decision-processes.[28] So the provision of a cause of action to remediate a deficiency in care by the trustee ought, indirectly, to encourage trustees towards rational decision-making.

More generally, though, it is important to recognise that the duties imposed by trust law do not tell trustees precisely what they actually have to do. Nor does trust law impose

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26 See Part 2.4, above. Note this is not to ignore the burgeoning literature contesting both the empirical accuracy of the notion of the rational person and the role of the assumption of rationality in ensuring a closed-form solution for economic modelling. The question under consideration here is the extent to which trust law contributes to the achievement of the regulatory objectives, which have that assumption embedded within them. For a summary of the challenges to the empirical accuracy of the assumption of rational decision-making, see Daniel Kahneman, 'Maps of Bounded Rationality: Psychology for Behavioral Economics' (2003) 93(5) *American Economic Review* 1449. For analysis of the systemic impact of irrationality see Ernst Fehr and Tyran Jean-Robert, 'Individual Irrationality and Aggregate Outcomes' (2005) 19(4) *Journal of Economic Perspectives* 43. See also Robert Shiller, 'From Efficient Markets Theory to Behavioral Finance' (2003) 17(1) *Journal of Economic Perspectives* 83.

27 See Part 5.3.

28 Scott Donald, 'Prudence under Pressure' (2010) 4 *Journal of Equity* 44.

decision-criteria (as for instance economic theory would) on trustees. Rather trust law places accountability for the financial burden of any loss resulting from a lack of care or diligence in making decisions on the shoulders of the trustee. The decision processes of trustees thus occur within a decision environment corralled and conditioned by the overarching set of principles found in trust law but, subject to that, they can respond to the opportunities and constraints of the private markets. This might be expected to contribute to the processes of price discovery and negotiation that promote economic efficiency at a systemic level.

Trust law is not the only way that trustee decisions are regulated of course. Statute also has a role to play, as we saw in Chapters 3 and 5. The key trust law principles guiding trustee decisions are so important to the regulatory scheme that the *SIS Act* imposes them (albeit with the caveats identified in Chapter 5) on the governing rules of each and every superannuation fund.[29] However, as was argued in Chapters 3 and 5, that does not diminish the importance of trust law because those same statutory interventions are informed by and are designed to buttress, rather than replace, the trust law principles they resemble.

Trust law and the political transfer of responsibility

The superiority of private markets over public control of the allocation and use of capital in an economy is a central tenet of neo-classical economic thought.[30] It permeates policy in relation to the superannuation system also. For instance the Hon. John Dawkins when introducing the package of *SIS* legislation noted in respect of the absence of investment restrictions:

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29 *SIS Act*, s 52.

30 Freidrich Hayek, 'The Use of Knowledge in Society' (1945) 35(4) *The American Economic Review* 519.

> The Government has not been persuaded that there should be restrictions on the investment freedom of superannuation funds. This is likely to lead to poorer investment returns.[31]

No explanation of the basis for that conclusion was offered.

This Thesis does not need to interrogate whether private markets are more effective than public control in promoting economic efficiency. What is important here is the extent to which policy makers and regulators rely on trust law to promote efficiency, not whether trust law does in fact promote economic efficiency. The question asked here, then, is does trust law provide the government with what might colloquially be termed a 'scapegoat' that enables it to distance itself from the investment performance of the superannuation system?

It seems clear that it does. As a recent illustration, the government's response to the Global Financial Crisis ('GFC') was to establish a review into the governance, efficiency, structure and operation of the superannuation system, the Cooper review.[32] The Review's focus was overwhelmingly on the way the system mediated the interactions between individuals and private sector organisations and between private sector organisations *inter se*. The conduct of the Review, and the very fact that the government chose to institute a Review, point to a desire by the government of the day to distance itself from any perceived failures in the system and to allocate responsibility elsewhere, whether that be onto specific market participants or, in some cases, broader systemic dysfunction.

Trust law, with its emphasis on the responsibility of the trustee for all decisions, facilitated that transfer. Declining account balances, redemption freezes and other GFC-

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31 Dawkins, *Strengthening Super Security* (1992), 3.

32 Super System Review, Review into the Governance, Efficiency, Operation and Structure of the Superannuation System. See <www.supersystemreview.gov.au>.

related phenomena likely to attract adverse public reaction could be attributed to the decisions of trustees and their agents (including fund managers, custodians, fund managers and administrators). Somewhat paradoxically the government was able to present the parts for which it was responsible, the superannuation system as a whole and its regulator APRA, as a GFC success story[33] whilst simultaneously calling for the most comprehensive review of the superannuation system in two decades!

Thus the presence of a regulatory scheme, buttressed by the credibility of trust law and by the way trust law focuses attention on the office of trustee, has been used by successive governments to justify its non-interventionist stance in the superannuation system, a stance which policy makers and regulators guided by neo-classical sensibilities would regard as promoting economic efficiency.

Trust law and the systemic robustness inherent in distributed decision-making

There is another, more subtle, contribution that trust law makes to the promotion of economic efficiency. It relates to the systemic robustness inherent in distributed decision-making.[34] The concerns about de-centralised decision-making centre identified above can be recast in a simple risk/return framework. Analysis shows that systems with a de-centralised decision structure, such as Australia's superannuation system, can exhibit a resilience to internal errors and external shocks that would cripple more centralised systems. The avoidance of such catastrophic failure might reasonably be

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33 Nick Sherry, Minister for Superannuation and Corporate Law, Address to Association of Superannuation Funds of Australia National Conference (Speech delivered at ASFA National Conference, Auckland, 14 November 2008).

34 The term 'systemic robustness' is used here in preference to the more commonly employed 'systemic stability' because robustness more clearly recognises that it is the survival of the system, rather than whether the system 'stablises' (ie returns to a single point of equilibrium), that matters: Scott Page, *Diversity and Complexity* (Princeton University Press, 2011), 49 - 53.

regarded as having positive value from the perspective of long term economic efficiency.

Accuri and Dari-Mattiacci develop a simple model for analysing when centralised decision-making is more effective at a systemic level than de-centralised decision-making.[35] Although the model relies on a simple binary decision rather than a complex one such as identifying the optimal investment strategy for a superannuation fund, it can be applied here. It provides some interesting insights. Most importantly it provides some rigour to the intuitive recognition that a system in which decision-making is distributed will be more robust than one in which decision-making is centralised.

The basic intuition is straightforward. It is widely agreed that combining expertise is likely to lead to superior decisions.[36] So in a system with limited expertise (or, in practical terms, a limited number of experts) it may make sense to centralise that expertise. If the expertise possessed by the experts is uncorrelated, the product of that expertise when combined will be greater than any one expert could achieve on their own. As a result, everyone gets the benefit of the same, synergised decision-making. Such an enhanced decision process will make mistakes from time to time, but they will be fewer than would be made by any of the experts acting in isolation.

The problem that Accuri and Dari-Mattiacci's model investigates is that if a central agency, even one powered with all available expertise, 'gets it wrong,' that has systemic consequences of a potentially catastrophic nature. In contrast, if a local decision-maker in a de-centralised system 'gets it wrong,' there is only local damage. It may therefore turn out that society is better served in the long run by a system in which there are more frequent mistakes, but those mistakes are small in comparison to the system as a

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35 Alessandra Accuri and Giuseppi Dari-Mattiacci, 'Centralisation versus Decentralization as a Risk-Return Trade-Off' (2010) 53 *Journal of Law and Economics* 359.

36 See for instance James Surowiecki, *The Wisdom of Crowds* (Doubleday, 2004). This issue was addressed more fully in the discussion of the collegial decision-making of boards in Part 4.4 above.

whole, than a system which is usually flawless but experiences systemic failure of catastrophic magnitude when a mistake is made.[37] The presence of diversification at a system-wide level, then, might be expected to help to make the system more robust.

There are two keys assumption in Accuri and Dari-Mattiacci's calculation. The first is the presence of expertise. If expertise is a limited resource that can be co-ordinated in a central decision-making location, then the value of that expertise in promoting more 'correct' decisions may outweigh the benefit to the system in distributing the risk. How much expertise is needed? Accuri and Dari-Mattiacci's most simple model (the only one for which they calculate an outcome) derives a value for expertise that is unrealistically high in the investment context, around an 80% chance of being right. So if individual experts are correct more that 80% of the time, there is no need to centralise decision-making.

That is a high hurdle indeed. There is a body of literature in the investment arena that suggests a 'hit rate' (however defined) of above 60% in investment is extremely rare, and that levels in the 52 – 55% range are both more realistic and sufficient to make a material difference to overall outcomes.[38] Empirical studies by Goyal and Wahal[39] as well as experimental studies by Clark et al[40] offer little hope that trustees might achieve 80% on key investment decisions.

But it would be a mistake to read too much into such a calculation. The decisions made by trustees in the superannuation are more complex than in Accuri and Dari-Mattiacci's

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[37] See recently Cally Jordan and Ankoor Jain, 'Diversity and Resilience: Lessons from the Financial Crisis' (2009) 32 *UNSW Law Journal* 416.

[38] The classic exposition of this view is Charles Ellis, *Investment Policy. Winning the Loser's Game*. *Timeless Strategies for Successful Investing* (Irwin, 2nd ed, 1993).

[39] Amit Goyal and Sunil Wahal, 'The Selection and Termination of Investment Management Firms by Plan Sponsors' (2008) 63(4) *Journal of Finance* 1805.

[40] Gordon Clark, Emiko Caerlewy-Smith and John Marshall, 'The consistency of UK pension fund trustee decision-making' (2007) 6 *Journal of Pension Economics and Finance* 91.

model; they are nuanced and embedded in continuous time. Moreover the calculation of maximum systemic utility that permits the identification of an optimal solution in their model does not apply in the present context because the objective of economic efficiency is just one of the regulatory objectives. The regulatory objectives include a concern for those at the bottom end of the distribution of outcomes; that's part of what 'member protection' is all about.

Perhaps more importantly, models such as Accuri and Dari-Mattiacci's assume a uniform set of needs across the population. In contrast, trust law ensures that fund trustees focus closely on the needs of their members. Because trustees are 'local', it is reasonable to expect that they will more clearly identify any unique needs of their membership that might escape the attention of some central agency or be compromised in pursuit of the interests of a whole. That presupposes that the beneficiaries of different funds might have different needs, of course, but the diversity of members across the system as a whole as a result of the SG makes this a plausible, albeit largely untested, hypothesis.[41] Trust law also aims to ensure that the decision-making of trustees is independent of distractions (such as conflicts) that would detract from the quality of their stewardship. So trust law is concerned to ensure that the local knowledge possessed by trustees is actually brought to bear directly on the decisions made in the system. That is tremendously valuable in a system where needs are heterogeneous. It would be equivalent, in Accuri and Dari-Mattiacci's model, of incorporating costs both for distance and heterogeneity, the inclusion of which would no doubt encourage their model to be more optimistic about the value of de-centralization.

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41 Scott Donald, '"Best" interests?' (2008) 2 *Journal of Equity* 245, 268, cited with approval in Daniel Mendoza-Jones, 'Superannuation trustees: Governance, best interests, conflicts of interest and the proposed reforms' (2012) 30 *Companies and Securities Law Journal* 297, 305.

Of course none of this should be taken to suggest that trustees ought not to be encouraged to acquire expertise, nor that the regulatory scheme should accept low levels of competence. Nor should the regulatory scheme necessarily promote the fragmentation of the system into ever-smaller, more local entities; there are economies of scale which make excessive fragmentation unduly costly. The analysis does however support the proposition that trust law's pre-occupation with the careful, faithful performance of trust obligations in pursuit of the best interests of members by trustees is a key component in the regulatory scheme. The derivation of local optima by trustees, though by no means a guarantee that a systemic optimum will be achieved, adds materially to the overall robustness of the system by giving it a granularity that a more prescriptive set of rules would struggle to achieve. That, in turn, ought to be positive from the perspective of economic efficiency.

The second key assumption in Accuri and Dari-Mattiacci's model is that the decisions (and most pertinently the mistakes) made by trustees are in fact uncorrelated. Trust law certainly encourages this. It requires trustees to exercise an independent judgment and, as we saw in Part 5.4 to focus their efforts by reference to the best interests of the members of the fund. To the extent that the needs of members differ across the system, this should promote a diversity of decision outcomes. Against this, the gravitational pull of peer pressure noted in Part 5.4 tends to reduce diversity. Divergences from standard industry practice become risky for both the trustee and, in some cases, the individual decision-makers. This is especially true in the not-for-profit sector where many of the individuals face an asymmetric payoff for risk. The post-GFC experience of funds such as MTAA and Westscheme illustrate this amply.[42] The trustees of both funds have come under great pressure when the differentiated (and successful)

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[42] See Shane Wright, 'WA industry super fund posts second worst result' *The West Australian*, 25 March 2010, 16; Lachlan Colquhoun, 'More mergers for Australia's 'Supers' *Financial Times*, 21 February 2011, 12; Jennifer Hewett, 'APRA to muscle up in dealing with super' *The Australian*, 9 February 2012, 19.

investment strategy they publicly championed before the GFC caused them to fall well behind the performance of competitors during the GFC.

There are also market circumstances that limit the diversity of investment strategies employed across the system. The most important of these is the concentration in the asset consulting industry that provides strategic investment advice to the trustees of superannuation funds. Although the role of asset consultants has evolved over the past twenty years,[43] and differs between funds, a small number of firms have traditionally dominated that sector of the industry.[44] The technologies employed by those firms in deriving the investment strategy recommendations they make to their superannuation fund clients are not differentiated to any great degree. As a result, the inputs into trustee decision-making and the methodologies employed in decision making have been very similar across funds. Similar decisions should therefore be no surprise. The diversity of decision-making that appears from the existence of having the trustees of many hundreds of funds exercising an independent judgment specifically tailored to the needs of their members may therefore be undermined by the practical operating and structural realities of the system. This in turn limits the extent to which trust law's close attention to the needs of members in fact translates, at a systemic level, to a diversified, de-centralised set of decisions of the type sought by Accuri and Dara-Mattiacci.

Individual Choice

The third of the modalities identified above as being conducive to the pursuit of economic efficiency is the facilitation of individual consumer choice.

Individuals are provided with choice at a number of levels within the superannuation system. The advent of Fund Choice means that all employees can choose to have their

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43 See for instance Penny Prior, 'Outsiders lose inside running' *Australian Financial Review*, 14 April 2012, 29.

44 Kevin Liu and Bruce Arnold, 'Australian superannuation outsourcing – fees, related parties and concentrated markets' (*Working Paper*, APRA, July 2010), 25.

superannuation contributions placed in a complying fund different from that selected as a default by their employer.[45] In most cases members will also be provided a choice of investment and other options within the superannuation fund,[46] a choice which in some cases extends even to the selection of individual securities. Some employees can even elect whether to enter into a defined benefit or defined contribution scheme, though this is becoming less common. And finally, individuals can choose to opt out of the intermediated superannuation sector altogether and establish a Self Managed Superannuation Fund (SMSF). The fact that trust law can accommodate member investment choice (albeit with the caveats described in Part 5.4), different scheme designs and even the formation of SMSFs suggests that, in theory at least, its facilitation of choice can be added to the list of ways in which trust law promotes economic efficiency.

There are a number of arguments supporting the presence of such individual choice in the superannuation system. Several were nominated in Chapter 2. It has, for instance, an obvious libertarian appeal – it permits individuals to assert greater control over their financial well-being. This acts as a partial counterbalance to the paternalism inherent in the compulsion to contribute resulting from the Superannuation Guarantee.[47] Choice also further distances the government from accountability for any financial shortfalls

45 For a description see Chapter 1 above.

46 Joshua Fear and Geraldine Pace, 'Australia's 'Choice of Fund' Legislation: Success or Failure?' (2009) 2(2) *Rotman International Journal of Pension Management* 26, 27.

47 Michael Drew and Jon Stanford, 'Why Is Superannuation Compulsory?' (2004) 37 *Australian Economic Review* 184.

resulting from poor choices,[48] though as recent events have demonstrated that doesn't necessarily stop those affected seeking financial assistance from government.[49]

As was also noted in Chapter 2, for economists such as Drew and Stanford, the provision of choice allows the system to approach greater allocative efficiency.[50] Though aggregation of members into funds permits pooling, and hence economies of scale, it also involves a compromise in terms of the precise calibration of investment strategies to individual member needs. Permitting individuals to choose funds and investment options in a relatively unfettered way permits the market mechanism to operate more freely, which neo-classical economists would expect to improve overall economic efficiency.

Against this, the empirical research in the superannuation arena inspires doubt whether individuals in fact exercise that potential for choice in a way that generates the market discipline sought by economists. This research suggests that disengagement,[51] lack of financial literacy[52] and agency conflicts[53] conspire to undermine the positive effect

48 Commonwealth of Australia, Financial Systems Inquiry, *Final Report* (March 1997), 192. Also Helen Coonan, *A Brief Guide to Superannuation*, (Commonwealth Treasury, 2002), 19.

49 See for instance Stuart Washington, 'DIY funds need compensation too' *Sydney Morning Herald*, 6 June 2011, 9; 'Regulator urged to go easy on super' *The Australian*, 8 June 2011.

50 Drew and Stanford, above n 47.

51 See for instance Tim Fry, Richard Heaney and Warren McKeown, 'Will investors change their superannuation fund given the choice?' (2007) 47 *Accounting and Finance* 267.

52 See for instance Marilyn Clark-Murphy and Paul Gerrans, 'Choices and Retirement Savings: Some Preliminary Results on Superannuation Fund Member Decisions' (2001) 20 *Economic Papers* 29; Marilyn Clark-Murphy and Paul Gerrans, 'Apparently Contradictory Superannuation Choices among younger fund members: a misunderstanding of risk?' (2004) 23 *Economic Papers* 101; Diana Beal and Sarath Delpachitra, 'Community Understanding of Superannuation; (2004) 11 *Agenda*; Benjamin Langford, Robert Faff and Vijaya Marisetty, 'On the Choice of Superannuation Funds in Australia' (2006) 29 *Journal of Financial Services Research* 255; Josh Fear and

expected.[54] This is further exacerbated by the increase in administrative cost that necessarily accompanies the provision of such choice. Thus the fact that trust law can accommodate such choices may not in practice promote economic efficiency.

Geraldine Pace, 'Choosing Not to Choose. Making superannuation work by default' (2008) *Australia Institute Discussion Paper 103*; Paul Gerrans, Marilyn Clark-Murphy, and Craig Speelman 'Drivers of individuals' superannuation investment choices: Preliminary evidence on return chasing and demographics' (2009) 30(1) *Journal of Family and Economic Issues* 4; Paul Gerrans, Marilyn Clark-Murphy, and Craig Speelman, 'Asset allocation and age effects in retirement savings choices' (2010) 50 *Accounting and Finance* 301.

53 Nick O'Malley, 'Super fees switch throws workers to the wolves' *The Sydney Morning Herald*, 18 March 2009, 1; Eric Johnston, 'Super fees review urged to unmask the fund flippers' *The Sydney Morning Herald*, 20 July 2009, 17.

54 Cooper Review, *Final Report: Part One*, [3.3].

Part 8.3 Trust law and member protection in the superannuation system

There is no shortage of statements in the case law expressing trust law's intense concern with the interests of beneficiaries.[55] These statements, and the analysis and commentary they have inspired, suggest that trust law might contribute to the achievement of the member protection objective identified in Chapter 2.

There can be no doubt that trust law is attentive to the rights of beneficiaries. However trust law's contribution is much more conditional than the rhetoric in the case law and commentary might suggest. That is to say, it is not that trust law simply privileges the rights of beneficiaries (and hence members) over other parties. Rather, there are circumstances when trust law intervenes to allocate accountability to the trustee and others where, absent such intervention, the burden of any loss would otherwise have been borne by the beneficiary or beneficiaries.[56] It is thus the impact that trust law has on the location of risk and responsibility, in different circumstances and given the presence of other juridical sources of rules, that determines the extent and circumstances in which trust law promotes the objective of 'member protection'.

A comprehensive description of where accountability lies in the superannuation system in every conceivable circumstance would be an impossible task. There is simply too much diversity in trust instruments at a local level and too wide a range of real-world phenomena to derive a comprehensive picture.

The approach taken in this Part therefore is to focus attention on two of the most important aspects of member protection in the superannuation context: who bears the

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55 See for instance *Cowan v Scargill* [1985] 1 Ch 270, 287; *Keech v Sandford* (1726) Sel Cas T Ch 61; 25 ER 223.

56 There are also a limited number of circumstances where ultimately the accountability may lie with a third party, for instance when the trustee validly appoints an agent: *Speight v Gaunt* (1883) 9 App Cas 1.

burden of a loss if the superannuation retirement savings of an individual are inadequate to fund that individual's expenditure in retirement? and what recourse do members have if the trustee pursues objectives not aligned with theirs? In both circumstances it is clear that trust law plays an important role in the regulatory scheme. It is also clear that, even with the normativity described in Chapter 7, trust law cannot always, by itself, secure the interests of members to the extent expected by policy makers. Policy makers have thus had to employ statutory and other means to buttress, and in places enhance, trust law's protection of members.

In the final segment of this Part, the analysis considers a paradox at the heart of trust law. The paradox is that the paternalism inherent in trust law which, on the one hand, is such a powerful source of protection for members, at the same time privileges trustee decision-making to such an extent that that trustee decisions are materially insulated from monitoring and review by members. In a broader regulatory environment in which disclosure and transparency is so often seen as a pre-requisite of accountability,[57] such opacity is anomalous indeed.

Trust law and accountability for financial shortfalls

As we saw in Chapter 1, the purpose of the superannuation system is to provide a means by which individuals will save during their working (earning) lives to accumulate assets that can fund some, or all, of their expenditure in retirement. As was also noted there, the superannuation system is not the only means by which such saving can occur, but it is clearly anticipated by policy makers that the superannuation system will be the primary avenue for such individual saving.

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57 Dimity Kingsford Smith, 'Is "due diligence" dead? Financial services and products disclosure under the Corporations Act' (2004) 22 *Company and Securities Law Journal* 128; Gail Pearson, 'Risk and the Consumer in Financial Services Reform' (2006) 28 *Sydney Law Review* 99.

There are of course a great many factors that will determine whether in fact an individual has an adequate 'nest egg', including superannuation entitlements, to fund a dignified standard of living in retirement. Many, such as the rate of contribution mandated under the Superannuation Guarantee, the taxation regime applied to the system, the pattern of contributions arising from different career trajectories[58] and the availability and quantum of the state-provided Age Pension[59] are outside the scope of this Thesis.

There are however a number of areas where trust law engages directly with the issue of the risk of a shortfall in the amount required by the member. Trust law is for instance vitally concerned with, and hence provides criteria for, allocating accountability for losses in the fund resulting from fraud or improvident investment. These two important risks deserve further examination.

Trust law and fraud

The potential for fraud by a participant in the superannuation system to cause loss to an individual member, or group of members, is very real.[60] The fraudulent party may be the trustee, an agent of the trustee or another member of the fund. Or it may be some other party purporting to be one of those people. In each case, though, the financial burden of the loss caused by the fraud will be borne by the beneficiaries unless the regulatory scheme intervenes to re-allocate that loss. The regulatory scheme is alive to this potential and responds in a variety of ways.

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58 Sarah Vickerstaff and Jennie Cox 'Retirement and risk: the individualisation of retirement experiences?' (2005) 52(1) *Sociological Review* 77; Ewald Engelen 'Changing work patterns and the reorganization of occupational pensions' in Gordon Clark, et al (eds), *Oxford Handbook of Retirement Income* (OUP, 2006).

59 Hazel Bateman and Susan Thorp, 'Choices and Constraints Over Retirement Income Streams: Comparing Rules and Regulations' (2008) 84 *The Economic Record* 17.

60 Tom Valentine, 'Is Superannuation Safe?' (2003) 36(1) *Australian Economic Review* 108, 113.

We can set aside as trivial (in this context at least) the situation where the trustee itself acts fraudulently. In that circumstance, depending on the nature of the fraud, trust law, the broader regulatory scheme and perhaps even the relevant criminal laws of the jurisdiction will apply to hold the trustee and any accessories accountable.

But what if the trustee is not the author of the fraud? In trust law generally, the trustee will be liable to make good any losses incurred by the trust arising from conduct on the part of the trustee that is shown to be lacking due care.[61] So, as we saw in Part 5.3, a failure by a trustee to conduct adequate due diligence enquiries in the course of considering an investment for the trust could give rise to a liability on the part of the trustee for losses flowing from that failure.[62] Thus the financial burden of remediating a loss incurred by a superannuation fund as a result of an investment in, for instance, an investment vehicle promoted in the Maddoff[63] or Trio frauds,[64] would be imposed on the trustee if it could be shown that the trustee had exercised inadequate care. In other words, a failure by the trustee to demonstrate a specific quality of trusteeship (care) would cause the location of the financial burden to shift from the beneficiary to the trustee.

Consider, however, a different type of fraud, one where the trustee pays trust monies to a person in the mistaken belief that that party is entitled to the payment (perhaps because the person fraudulently impersonated a real beneficiary).[65] Such a payment is

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61 *Speight v Gaunt* (1883) 9 App Cas 1.

62 See text accompanying nn 134-145 in Part 5.3 above.

63 For a description, see Erin Arvedlund, *Too Good to be True: The Rise and Fall of Bernie Madoff* (Penguin, 2009).

64 See for instance Tehani Goonetilleke, 'Obligations and liabilities of the key players in managed investment schemes: Contentious questions arising from Trio Capital' (2011) 29 *Companies and Securities Law Journal* 419.

65 On the vulnerability of superannuation funds to identity fraud, see John Kavanagh, 'Super in the Spotlight' *Sydney Morning Herald*, 16 Nov 2011, 8.

a breach of trust and the trustee will be liable to reimburse the trust.[66] The beneficiaries will not be required to demonstrate an absence of care or a deficiency in respect of any of the other qualities of trusteeship because the courts view the distribution as not having taken place and simply require the trustee to replace the sum distributed (plus interest, if relevant).[67] The criterion for re-allocating the burden of the financial loss to the trustee in this case is thus more protective of members in respect of mis-payments than it is in respect frauds incurred through investment vehicles.

Ought it to matter which type of fraud the trust has suffered? Ought the beneficiaries be required to demonstrate a deficiency in care in respect of the second kind, the mis-payment, in order to make the trustee accountable? Or alternatively, ought the trustee who purchased, on behalf of the trust, investments that turned out to be instruments of fraud be strictly liable to compensate the trust, even if they exercised 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?

Ultimately, this is a policy question. General trust law gives effect to one set of consequences (in this case differentiating between the circumstances), but it is for policy makers to decide whether that set of consequences is apt. In NSW, trustees (including superannuation trustees by virtue of s 350 of the *SIS Act*) can seek to be excused from personal liability for the breach under s 85 of the *Trustee Act 1925* if they acted honestly and reasonably, and ought fairly to be excused for the breach. There is no reason why trustees of superannuation funds could not use this provision to seek to be excused of accountability for mis-payments induced by fraud. The difference however is that the onus of proof in such an application would rest with the trustee, not the beneficiaries.

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66 *Eaves v Hickson* (1861) 301 Beav 136; 54 ER 840.

67 *Re Hulkes* (1886) 33 ChD 552; *Hilliard v Fulford* (1876) 4 ChD 389.

In the superannuation system, policy makers have gone one step further. Part 23 of the *SIS Act* makes provision for the grant of financial assistance from the Commonwealth government for funds that have suffered loss as a result of fraudulent conduct or theft. The loss must have:

> caused substantial diminution of the fund leading to difficulties in the payment of benefits[68]

and the Minister, in deciding whether to grant financial assistance must have regard to the 'public interest' in making such an order.[69] In superannuation, then, we see the general trust law position (and the differentiated allocation of accountability it brings about) modified by both non-specific statutory intervention (potentially relieving the trustee of accountability) and by superannuation-specific intervention (potentially giving parties access to public funds for recompense). The starting point, though, is trust law because the re-allocation of accountability potentially available under statute relies on the discretion of the court and the responsible Minister respectively.

This analysis, of course, assumes that the trust instrument does not contain an exculpation clause limiting the trustee's liability for breach. Depending on the wording of that clause, and the interpretation of that wording by the courts, the trustee may escape personal liability for losses caused by another party's fraud in certain circumstances (typically again where there has been no dishonesty).[70] Once again, though, statute intervenes in the superannuation context, with, as we noted in Chapter 4,[71] s 56(2) of the *SIS Act* limiting the scope of exculpatory and indemnification clauses. So once again policy makers have employed statute to limit the re-allocation of

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68 *SIS Act,* s 229(1)(b).

69 *SIS Act,* s 231(1)(a).

70 *Armitage v Nurse* [1997] 2 All ER 705. For a general discussion, see Gino Dal Pont, 'The Exclusion of Liability for Trustee Fraud' (1998) 6 *Australian Property Law Journal* 1.

71 See text accompanying nn 80-81 in Chapter 4.

accountability away from the trustee and thereby buttress trust law against circumvention by opportunistic drafting.

Trust law and investment losses

Failure of the investments of the trust to achieve an adequate rate of return is another, very important, way in which a shortfall in assets could arise. Again there are rules in trust law that re-allocate accountability between the trustee and the members, and again that re-allocation is conditional and contingent.

The trustees of superannuation funds almost inevitably have to invest trust assets in securities and financial instruments that carry some risk of temporary capital depreciation in order to achieve the rates of return required by members.[72] As we saw in Part 5.3, such a step might at one time have been deemed imprudent for a trustee.[73] As was also detailed there, today it is recognised that investment in listed securities, in real property, in contracts for exchange and in derivatives contracts may be acceptable, so long as they are required to achieve the financial objectives of the fund. Freed from the shackles of the court lists, trust law is able to consider, and where appropriate, accommodate contemporary technology with respect to investment strategy and implementation.

That in turn means that trustees cannot be held liable for all investment losses incurred by the trust. As Lindley LJ noted in *Re Chapman*, a trustee is not:

> a surety, nor is he an insurer; he is only liable for such wrong done by himself, and loss of trust money is not per se proof of such wrong... There is no rule of law which compels the Court to hold that an honest trustee is liable to make good loss sustained by

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72 Donald, above n 28, 52.

73 See text accompanying nn 51 – 93 in Part 5.3.

> retaining an authorized security in a falling market, if he did so honestly and prudently, in the belief that it was the best course to take in the interests of all parties.[74]

So trustees must still be careful, diligent and orientated towards the financial best interests of beneficiaries. Moreover, as we saw in Chapter 5, these concepts (care, diligence, best interests) are not defined exogenously; the standards they invoke are an inalienable part of trust law. The courts have, over the years, developed jurisprudence that defines and calibrates the standards as they apply to trustees.[75] In fact, it is arguable that it is specifically the calibration of those standards that gives trusteeship of an express trust such as a superannuation fund much of its unique character. Thus here, in this respect also, trust law creates a nuanced and sophisticated matrix of accountabilities, in which the location and extent of accountability applying in each circumstance is conditional on standards and on qualities of conduct derived from the case law. And it is this nuanced and conditional set of standards and qualities that trust law contributes to the regulatory scheme and which, in part and in conjunction with the other elements of that scheme, promotes achievement of the member protection objective.

There are several additional factors to be considered.

The first is that what constitutes a remediable 'loss' is today much harder to define than in earlier centuries. As *Cowan v Scargill*,[76] *Harries v Church Commissioners for England*[77] and *Nestle v National Westminster Bank*[78] make clear, trustees of trusts established to

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74 [1896] 2 Ch 763, 775 – 776.

75 This is not to suggest that such standards are static. That there has been evolution in the standards and that they incorporate societal expectations at least to some extent was discussed in Chapter 5.

76 [1985] Ch 270.

77 [1992] WLR 1241.

78 [1994] 1 All ER 118.

provide financial benefits to members, or for a charitable purpose, can no longer regard capital preservation as the benchmark for investment performance. Earning a rate of return above inflation, perhaps even one consistent with the risk tolerance of the beneficiaries,[79] is required. In *Nestle,* in particular, the court had to determine whether an investment portfolio that had grown in value, but had not achieved a rate of return as great as that alleged by one beneficiary to have been required, could be said to have suffered a loss. The court found, on the facts, that it had not suffered a loss that would attract its intervention.[80] However the court's approach in that case clearly signals a preparedness to recognise that a trustee could be liable to compensate a trust not only for actual financial losses but also for gains that ought to have been made, but were not.

The second complicating factor is that so long as a trustee has exercised due care and each investment is consistent with the overall strategy, it will not be open to beneficiaries to seek remediation in respect only of those investments that have failed to achieve the expected rate of return.[81] Despite appearances, this is in fact not a departure from the 'line by line' approach traditionally applied in trust law. Each investment still needs to be appropriate for the needs of the trust. What is different is that, as modern portfolio theory demonstrates, the assessment must have regard both for the overall portfolio context and the presence, *ex ante*, of uncertainty.

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79 It is a moot point whether the risk level appropriate for the investment strategy more properly derives from the rate of return required to achieve the desired funding outcome or from the individual emotional preferences of the beneficiaries. Economic theory does not provide any unequivocal answers. Not surprisingly, the courts have yet to confront such conceptual niceties.

80 *Nestle*, above n 78 1269 (Dillon LJ), 1276 (Staughton LJ) and 1285 (Leggatt LJ).

81 *Nestle v National Westminster* (1996) 10(6) TLI 112.

It is also the case that trustees are required to ensure that the investment strategy is appropriate for the needs of the beneficiaries, not individually but as a whole.[82] As we saw in Part 5.4, this is a consequence of the requirement that trustees exercise the investment power in a way that is impartial as between different classes of beneficiaries.[83] The challenge for trustees of a fund administering a typical defined contribution scheme is that although the members are unlikely to be easily classified into the life interest/remainderman or capital/income classes on which such trust law rules traditionally rely, that does not mean that there will be any one investment strategy that will be optimal for all members simultaneously. Some members are likely to find any given strategy too risky and some too conservative; heterogeneity in the members' needs and risk appetite is almost inevitable. The accountability of the trustee to beneficiaries, therefore, is owed individually in the sense that individual beneficiaries can take action against the trustee, but that does not mean that an individual for whom the investment strategy was not personally optimal (because they he or she was either more or less risk tolerant than their peers) will have a right of action. Whether there is a loss to be remediated by the trustee will depend on whether there has been a shortfall for the beneficiaries as a whole. The trustee will not be liable to remediate in respect of all shortfalls experienced by any member in isolation; its duty is to invest carefully in pursuit of the investment objective set for the fund as a whole. Thus here, again, the matrix of accountabilities embodies distinctions that are more subtle than might appear on the surface.

Finally, the duty owed by the trustee may be conditioned by the trust instrument. Regard must of course be had for the effect of exclusion of liability and exculpatory clauses. Beyond those, however, there may be other provisions, such as those

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82 *Cowan v Scargill*, above n 76, at 286-7. See also Michael Vrisakis, 'The best interests of beneficiaries viewed as a hole' (2009) 20(5) *Australian Superannuation Law Bulletin* 71.

83 See text accompanying n 235 in Part 5.4.

governing the terms of any investment choices offered to members, which may condition the accountability. As was discussed in Part 5.4, there remains an element of uncertainty as to how far a trustee will be liable for a loss incurred by a member who has instructed that trustee to invest their contributions in a specific investment option. The assessment of whether due care was taken by the trustee will have to have regard for the presence of such an instruction, meaning that while a failure to comply with the instruction expeditiously (for instance) might gave rise to accountability for the trustee, the mere fact that the investment did not perform as well as expected would not.

That much is the effect of trust law. Policy-makers have however used statute to buttress some of these rules. The covenants in s 52(2) give statutory support for the trust law requirements in relation to acting with care and diligence and in the best interests of members. In addition s 55(5) of the *SIS Act* confirms that the performance of an individual investment within a portfolio must be assessed in the context of the investment strategy overall, and the covenant in s 52(2)(f) provides a non-exhaustive list of criteria relevant to the formulation and implementation of that strategy. Finally, s 52(4) permits the trustee to act in accordance with an investment direction provided by the member. When combined with s 55(5) this reduces the potential for trustees to be held liable for losses arising from the failure of an investment option selected by a member to perform as well as expected but leaves in place the possibility of liability arising from an absence of care or diligence on the part of the trustee. Thus, as we saw in more detail in Chapter 5, none of these provisions alter the matrix of accountabilities present in trust law to any great extent, but their inclusion in the statutory regime renders them less susceptible to erosion through private negotiation by participants in the system.

A quick detour in respect of defined benefit funds

The discussion so far presupposes that the fund in question is administering a defined contribution scheme. Inevitably the matrix of accountability is even more complex when defined benefit schemes are involved. Again however it is largely left to trust law principles to determine how this additional complexity is navigated and to what extent members can expect to be protected from the realisation of adverse investment outcomes in the fund's investment portfolio. Absent a deficiency of care on the part of the trustee, the presence and quantum of any 'loss' arising from a shortfall in the value of the assets will depend on whether the scheme is on-going or being wound-up.[84] Moreover, the provisions of the trust instrument will influence (and in some cases determine) where the burden of any financial shortfall ultimately lies. It could lie with the sponsoring employer or with the members.[85] Thus, in this context especially, the extent to which trust law can promote member protection is heavily contingent on the privately negotiated terms of the trust instrument.

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84 Richard Nobles, *Pensions Employment and the Law* (Clarendon Press, 1993), 143 - 7.

85 There may even be differences as between different classes of members (pensioners versus current members, for instance) within the fund. There are also timing and taxation-related differences for the members depending on whether they are required to contribute additional amounts to the fund to make up the shortfall or, alternatively, have their defined benefits reduced.

Trust law and the misapplication of trust assets

The scale of the accumulation of assets in the hands of private entities acting as superannuation trustees is arguably unprecedented in Australia. The 'Unseen Revolution' identified by Drucker[86] almost forty years ago gives rise, as we saw in Part 8.2, to tremendous agency issues for the state and for the economy as a whole.

These problems have an echo at a local level also. The quantum of trust assets available to fund the retirement expenditure of individual members could clearly be adversely affected if those assets have been applied in pursuit of objectives other than maximising investment returns. Those misapplications could be deliberate, as for instance where a trustee seeks to pursue its own commercial interests[87] or where the members of the board of trustees seek to promote the agenda of an appointing body.[88] The misapplications could alternatively be inadvertent, for instance arising out of a misapprehension by the trustee of the actual needs of the beneficiaries.[89]

Trust law provides two responses to the risk that trust assets may be misapplied. As we saw in Part 5.5, it provides that the investment power must be employed for a proper

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86 Peter Drucker, *The Unseen Revolution: How Pension Fund Socialism Came to America* (Harper Collins, 1976). The argument was famously reprised in Peter Drucker, *The Pension Fund Revolution* (Transaction Publishers, 1996).

87 See for instance Stephen Long, 'Key fund's woes put super at risk for thousands' *Australian Broadcasting Corporation News*, 13 Dec 2011; Duncan Hughes, 'Links cited as drag on returns' *Australian Financial Review*, 20 Jan 2011, 39.

88 See for instance *Cowan v Scargill*, above n 74. In Australia, such concerns have been voiced frequently by media commentators; see for instance Paul Fletcher, 'Just who is minding the minders of super?' *The Australian*, 20 Mar 2012, 28; Duncan Hughes, 'Lobby group to challenge MTAA role' *Australian Financial Review*, 11 May 2011, 55. But cf Mason, who views this as inherent in the equal representation requirements under the SIS Act; Sir Anthony Mason, 'Superannuation and Conflicts of Interest' (Paper presented at *Law Council of Australia Superannuation Conference* 2005).

89 Michael Drew and Jon Stanford, 'Principal and Agent Problems in Superannuation Funds'(2003) 36(1) *Australian Economic Review* 98.

purpose, namely investment, and not for some collateral purpose.[90] It also seeks to ensure that trustees do not make decisions in situations where their personal interests, or their duties to another, might come into conflict with the interests of the beneficiaries.[91] Both these responses engage directly with the possibility that a trustee may attempt to employ trust assets directly or indirectly to advance some other objective. And crucially both are areas where trust law has imposed stringent standards on trustees.

The regulatory scheme shaping superannuation implicitly incorporates these trust law rules. As we saw in Chapters 5 and 6, s 350 of the *SIS Act* expressly preserves any law of a State or Territory that is capable of operating concurrently with the other provisions of the *SIS Act*, including, it is submitted, the proper purposes and conflicts doctrines of trust law. Those doctrines are, moreover, given statutory reinforcement by the covenant in s 52(2)(c) that a trustee must ensure that its duties and powers are performed and exercised in the best interests of the beneficiaries. Finally, s62 of the *SIS Act* also provides protection to members in this regard. As we saw in Part 5.5, it requires the fund to be 'maintained' for the sole purpose of providing retirement benefits. Section 62 provision operates at a higher level than the proper purposes doctrine, but, like that doctrine, it is specifically designed to ensure that trustees employ trust assets for the purpose for which they were contributed to the trust; another safeguard for member protection.

The downside of paternalism from a member protection perspective

There is one final trust law paradox in relation to the objective of member protection to be confronted. It is apt to described trust law as 'paternalistic.' Trust law both

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90 *Re Power's Will Trusts* [1947] Ch 572.

91 *Crook v Smart* (1872) 11 SCR (NSW) Eq 121; *Williams v Barton* (1927) All ER 751. But cf *Re Drexel Burnham Lambert U.K. Pension Plan* [1995] 1 WLR 32.

privileges the judgment of one party (the trustee) and, as we have seen, holds that party responsible for the pursuit of the others' (the beneficiaries) interest. At one level, then, paternalism can be seen as protective of the beneficiary.

It is however important to recognise that there is an asymmetry inherent in paternalism. The obligation on the *pater* is counterbalanced by the constraints on personal freedom placed on the party subject to the paternalism. But equally that balance reflects and entrenches an imbalance of power between the parties. The vulnerable party remains vulnerable to the misbehaviour of the *pater* except to the extent that the law, trust law in this case, is prepared to intervene in support of his or her interests. As Cotterell observes:

> To the extent that law controls trustees, the risk of relying on them is reduced and the moral relationship of trust is displaced from the trustee and attached to law itself. Thus ... instead of having to put one's moral trust purely in the trustee, one can have confidence in law which guarantees the trustee's proper behaviour.[92]

This highlights that the regulatory efficacy of duties such as those analysed in earlier chapters is undermined unless breaches of the duties can be detected and appropriate standards enforced. In that respect, Hayton,[93] in particular, has expressed concerns about how effective trust law's avowed protection of beneficiaries can be if settlors, or those responsible for drafting trust instruments, are free to incorporate self-serving (and hence beneficiary-depleting) processes, structures and terms into the trust instrument.

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92 Roger Cotterell, 'Trusting in Law: Legal and Moral Conceptions of Trust' (1993) *Current Legal Problems* 75.

93 David Hayton, 'The Irreducible Core Content of Trusteeship' in AJ Oakley (ed), *Trends in Contemporary Trusts Law* (Clarendon, 1968).

Access to information

Perhaps nowhere is the asymmetry of paternalism more effectively illustrated that in the limits that trust law places on a beneficiary's right to information about the administration of the trust. As Hayton and others have observed,[94] access to information about the administration of the trust is a pre-condition for any effective mechanism of accountability. If the beneficiaries cannot find out what the trustee has done and decided, their ability to secure their interests as beneficiaries is severely compromised.

A beneficiary's access to information at trust law has typically been limited to 'trust documents.'[95] The courts have found that this encompasses documents such as the trust instrument, financial accounts and legal advice relating to the administration of the trust,[96] but not documents that contain evidence that would reveal the reasoning behind exercise of a trustee's discretion.[97] Importantly, a more general definition of the term 'trust documents' remains elusive. The *locus classicus* that trust documents are:

> a document in the possession of the trustees as trustees that contains information about the trust that the beneficiaries are entitled to know[98]

is transparently circular.

Tierney v King[99] and *Crowe v SERF*[100] highlights how this lack of clear definition can have an impact on the rights of superannuation fund members. In *Tierney v King* the plaintiff

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94 Hayton, above n 93; Lisa Butler, 'Reviewing Trustees' Discretions: The Right to Reasons' (1999) 7(3) *Australian Property Law Journal* 1; Dimity Kingsford Smith, 'Who Knows Best? Review of Discretionary Powers in Superannuation Funds' (2000) 28 *Australian Business Law Review* 428.

95 *O'Rourke v Darbishire* [1920] AC 581.

96 *Hartigan Nominees v Rydge* (1992) 29 NSWLR 405.

97 *Re Londonderry's Settlement* [1965] Ch 918.

98 Ibid, 938.

sought, and was denied, access to the actuarial reports of the fund. The court's decision to deny access was on the grounds that the reports were both subject to a confidentiality clause in the trust instrument and contained information of a nature that would 'bear upon or affect' the exercise of the trustee's discretionary power. In *Crowe v SERF* the plaintiff sought access to certain 'internal working documents of the trustee', including actuarial reports of a type similar to those sought in *Tierney v King*. In *Crowe v SERF*, however, Bamford J chose to follow the lead of the New South Wales Court of Appeal in *Hartigan*,[101] and to require disclosure on the grounds that such documents did not betray trustee reasoning and hence did not contravene the principle adduced in *Re Londonderry*[102] that documents disclosing trustee reasoning should not be available to beneficiaries. Notwithstanding that the plaintiff in *Crowe v SERF* was ultimately successful, it is hard not to sympathise with Butler[103] and Kingsford Smith[104] when they argue that the application of trust law principles in this context unduly privileges the trustee.

The regulatory scheme does provide some assistance to members in this regard. The *SIS Act* and *Corporations Act* together impose a duty on trustees to provide certain types of generic information to members on request. Section 52(2)(h) of the *SIS Act*, as amplified by Regulation 4.01, invokes s 1017C of the *Corporations Act* 2001, which provides that a concerned person (defined to include a member) has the right to request and then receive such information as might reasonably be required to understand the main features and investments of the superannuation fund and to make an informed judgment about the management, financial condition and investment

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99 [1983] 2 Qd R 580.

100 [2003] VSC 316.

101 Above n 96.

102 Above n 97.

103 Above n 94.

104 Above n 94.

performance of the superannuation fund of which they are a member, as well as their personal benefit entitlements.

The *SIS Regulations* and *Corporations Regulations* provide further definition of the types of information to which a member should have access. These include the risk management plan,[105] the audited accounts and auditor's report[106] and 'fund information'[107] but not working documents of the trustee.[108] 'Fund information' is prescribed in Subdivision 5.6 of Part 7.9 of the *Corporations Regulations 2001* to include all information that the trustee reasonably believes a member would reasonably need for the purpose of understanding the management and financial condition of the fund understanding the investment performance of the fund,[109] as well as details of the composition of the trustee (or corporate trustee) board,[110] the investment objectives of the fund,[111] any investment managers appointed by the trustee,[112] any holdings comprising more than 5% of fund assets[113] and the fund's derivative policy.[114] In essence, then, unless the umbrella provision requiring 'all information" reasonably required to understand the condition of the fund is interpreted broadly, members can only expect to receive pre-prepared documents in response to questions.

This duty to account is further reinforced by s 101 of the *SIS Act* which requires the trustee to establish arrangements to ensure that inquiries or complaints about the

105 *SIS Act*, s29D.

106 *SIS Regulations*, reg 2.33(2)(a).

107 *SIS Regulations*, reg 2.33(2)(b).

108 *SIS Regulations*, reg 4.02.

109 *Corporations Regulations*, reg 7.9.35.

110 *Corporations Regulations*, reg 7.9.37(b).

111 *Corporations Regulations*, reg 7.9.36.

112 *Corporations Regulations*, reg 7.9.37(a).

113 *Corporations Regulations*, reg 7.9.37(g).

114 *Corporations Regulations*, reg 7.9.37(h).

'operation or management of the fund in relation to that person' are properly considered and dealt with within 90 days. Notably, though, the conventional wisdom about this provision is that it does not extend to questions affecting all members, merely those where the member is uniquely affected. If that interpretation is correct, it seems unduly restrictive; a member's interests can just as easily be adversely affected by decisions affecting all members as they can by those relating to him or her uniquely. Indeed, the outcome is, loosely, a reversal of the situation at general law in which the courts protect dispositive decisions affecting the individual from enquiry to a far greater extent than other aspects of the administration of the trust.

The picture that emerges from these statutory and regulatory requirements is one closer in character to financial services disclosure than trust law accounting. There appears to be no impetus for disclosure of information of a type that would truly make the trustees of superannuation funds and their officers accountable to members. This is a serious deficiency in a regulatory scheme genuinely seeking to achieve member protection.

Review of trustee decisions

Trust law's paternalism can also be seen in the reluctance of the court to review those trustee decisions that are characterised as exercises of 'discretion',[115] reluctance which carries over to the superannuation field today.[116] It is seen most often where members challenge the decisions of their fund's trustee in relation to claims for payment of total and permanent disability (TPD) benefits. Consistent with trust law generally, the courts have been loath to review the merits of trustee decisions in respect of TPD claims absent evidence of mala fides or a failure to give real and genuine consideration to the

115 *Karger v Paul* [1984] VR 161.

116 Lisa Butler, 'The Legitimate Bounds of a Trustee's Discretion' (1999) 11 *Bond Law Review* 14; Kingsford Smith, above n 94.

matter.[117] This, despite the fact that most beneficiaries claiming under such policies in a superannuation fund have provided consideration for the coverage.

It is perhaps therefore not surprising that there have been attempts, not yet wholly accepted by the courts, to recast these trustee decisions in a way that avoids the consequence of having the decision deemed to be 'discretionary.' Campbell [118] has for instance suggested that they may be better characterised as decisions of fact in which the trustee has a duty to collect, collate and apply relevant data to a pre-determined decision algorithm. Such a characterisation removes the 'discretionary' element and provides the courts with much greater scope to review any decision taken by the trustee. There are dicta in the High Court's decision in *Finch v Telstra*[119] that would appear to support such an approach, but as Thomas points out,[120] this interpretation of the High Court's decision is not entirely without problems because at some point the trustee has to exercise a judgment and so the distinction between what is a discretionary decision and what is not is hard to draw with confidence.

Would such an approach open the floodgates to vexatious and unconstructive enquiries by members? Perhaps, but following the lead of Balmford J in *Crowe v SERF*[121] when granting a member access to certain documents in the possession of the trustee, it is perhaps apposite to note the words of Lockhart J in *Byron Environment Centre Incorporated v Arakwal People*:

117 See for instance *Rapa v Patience* (Unreported, Supreme Court of New South Wales, McLelland J, 4 April 1985); *Maciejewski v Telstra Super Pty Ltd* [1999] NSWSC 341; *Telstra Super v Flegeltaub* (2000) 2 VR 276.

118 Joseph Campbell, 'Exercise by superannuation trustees of discretionary powers' (2009) 83 *Australian Law Journal* 159.

119 *Finch v Telstra Super Pty Ltd (No 2)* [2010] HCA 36.

120 Geraint Thomas, *Thomas on Powers* (OUP, 2nd ed, 2012), [11.37].

121 [2003] VSC 316, [42].

> If it be said that this is too broad an analysis and that the floodgates will open, then I must say that over the past years on the Bench of this Court I have never seen the floodgates open in any matter, despite dire predictions to the contrary. [122]

The Superannuation Complaints Tribunal represents the regulatory scheme's main response to this feature of trust law. As we saw in Chapter 2, it provides a (relatively) low cost and expeditious mechanism for members to challenge certain types of decisions made by the trustees of superannuation funds. Table 4 below provides a statistical summary of the types of matters coming before the SCT in recent years. It highlights that a large number of claims relate to the trustee's decision in relation to the binding death benefit nomination (included under 'Death') and the trustee's decision in relation to entitlement to disability benefits (included under 'Disability'), areas in which the trustee is required to form a judgment on the merits of the circumstances presented. A smaller number relate to claims of malfeasance of a more general nature by the trustee, such as misrepresentation of fees, which are found within the category 'Disclosure, insurance and fees.'

122 (1997) 78 FCR 1, 19.

Table 4

	Number of Complaints				
	Jun 1995	Jun 2001	Jun 2005	Jun 2010	Jun 2011
Written complaints received	1700*	1,856	1,934	2,481	2,459
- within jurisdiction	881	883	1,062	1,487	1,496
	Breakdown by Type of Complaint (%)				
Death	8.0	24.7	31.4	34.5	33.2
Disability	14.0	30.6	27.8	10.5	12.7
Disclosure, Insurance & Fees	20.0	5.7	6.4	15.1	12.4
Payments (Delay, Early Release)	20.0	16.9	14.8	21.0	21.2
Administration	38.0	21.0	17.7	17.4	19.0
Other		1.2	1.9	1.5	1.5

* estimate

The decisions being reviewed are essentially personal in nature in the sense that they relate specifically to the individual member. Indeed, as we saw in Chapter 2, the SCT's jurisdiction expressly excludes matters relating to the 'management of the fund as a whole.'[123] It seems, then, that even the SCT does not address the issue that there is little that a beneficiary can do (outside the discovery processes of adversarial proceedings) to understand why particular administrative decisions, such as the appointment of an agent (such as the fund administrator, an investment manager or the auditor) or the formulation of an investment strategy, were made the way that they were. Yet those decisions can affect a members' achievement of his or her retirement objectives just as surely as the types of decisions currently within the SCT's jurisdiction.

123 *SRC Act*, ss 14(6), 15F(4) and 15J(4).

The remedial dimension

Finally, it is apposite to provide an example that demonstrates that the paternalism inherent in trust law extends beyond doctrinal matters and includes the nature of the remedies available. When the trustee's decision has been found to be deficient in some respect, the court's instinctive reaction is to return the decision to the trustee to reconsider rather than to superimpose its own decision. This approach is of course typical of trust law, but remarkably was recently followed even when the trustee contested the member's claim all the way to the High Court.[124] The notion that the beneficiary could expect a fair hearing from the trustee after years of sustained, expensive and committed opposition from the trustee would strike most lay people as unrealistic in the extreme.

Paternalism and accountability

In each of the examples just described, trust law demonstrates a paternalistic ethos that has consequences that are arguably inappropriate in a modern superannuation context and, more importantly for present purposes, undermine any claim that trust law is unequivocally 'member protecting'. Of course, privileging the decision-making of a 'responsible' trustee has many positive aspects. Most particularly it enables regulatory scrutiny and accountability to focus on an identifiable, finite location. However the corollary is that the mechanisms to enable beneficiaries to hold trustees accountable are emaciated and in some respects perhaps even misconceived. This exacerbates the inevitable asymmetry of information and power present in the trustee/beneficiary relationship and, taken to together with the nuances substantivity described in the earlier analysis in this Part, undermines trust law's claim to advance unequivocally the regulatory objective of 'member protection.'

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[124] *Finch* , above n 119.

Concluding comments

Trust law's presence in the inter-legal regulatory scheme governing the superannuation system inevitably means that it influences the content of that scheme. What is less easily divined, and hence often misunderstood, is the precise nature of that contribution.

Trust law has little to say about economic efficiency directly. However its private law genesis enables it to accommodate behaviours and institutional forms that promote economic efficiency; in particular the modalities of competition and innovation, distributed decision-making and individual choice.

Trust law is more directly enrolled in promoting member protection. As the analysis in this Chapter has demonstrated, trust law does provide protection to members in certain circumstances. However that protection is by no means all-encompassing. It is contingent on trust law's interactions with other strands of the regulatory scheme. It is also conditioned on the circumstances of the fund. But more fundamentally, it is catalysed only where, and on the terms that, trust law is prepared to recognise. Thus the paternalism that generates rules relating to honesty, care, diligence and fidelity also has resulted in important shortcomings in the mechanisms available for members to monitor and challenge trustee decisions. These are shortcomings which are only partly addressed in the regulatory scheme by statute and regulations.

Conclusion

The superannuation system has become a foundation stone in Australian civil society. What was once the preserve of a privileged few has become in the past two decades a system of almost universal coverage. As a result of the Superannuation Guarantee, almost all adult Australians are members of at least one superannuation fund, some more. For many, that membership represents their greatest single financial asset. The amounts accumulated there will crucially determine the quality of life they can afford in retirement. At the same time, the $1.3bn already committed to the system represents a vast pool of capital, available for, and indeed requiring, investment in economic enterprise in Australia and overseas. The long term health of the economy requires that capital to be put to effective use. The government's 'investment' in the superannuation system therefore goes well beyond the taxation concessions that surround and sustain it. The government can accept local failures, but the consequences of systemic failure would be very serious for both social and economic policy in Australia.

The system is not one in which the risk of failure, local or systemic, can be eliminated by state-sponsored regulation however. Private markets, and the processes and institutions associated with them play a crucial role in the superannuation system. Clumsy or ill-directed regulation that distorts those processes could create unintended consequences of a quite dysfunctional nature.

The superannuation system relies on private markets in a variety of ways. At the most fundamental level, the system mediates between individuals' inter-temporal consumption plans and global capital markets. It provides a means by which individuals can accumulate savings to fund their expenditure in retirement, but equally it represents a mechanism by which those individual savings can be collected into pools of a size and character suited to mobilisation in global capital markets. At a more granular level, the process of accumulation is associated with the processes and institutions of the employment market; with unions, with employers and with the manifold ways in which the employment relation can be structured in a modern capitalist economy. In addition, with the passing of the *SIS Act* in

1993 the government implicitly chose to rely on private entities, including banks, insurance companies, and employer-sponsored and union-co-ordinated funds, to administer the system. They are responsible for collecting and investing the contributions, and when each member reaches retirement, distributing the proceeds of that investment. These institutions, in turn, contracted with other private entities, specialists such as investment managers, investment consultants, custodians and administrators, to assist in the administration of these intermediated pools of capital. And finally, the government enrolled the audit and actuarial professions to oversee key aspects of processes that are integral to the administration and, ultimately, the regulation of the trustees and their agents. The system is thus crucially dependent on private market processes and institutions.

The regulatory scheme governing superannuation has to accommodate and engage with that complexity and dynamism. As we have seen, it does so in a much more complex way than is sometimes recognised. The involvement of private markets means that much of the legal framework for the superannuation system derives from private negotiations; from trust law, from the web of contracts that constitute the 'virtual' institution of the superannuation fund, from contracts entered into in the investment markets and from the employment relationships that give rise to the contributions. These each help to define the legal relationships and responsibilities that exist between participants in the system. As such, these 'meta-connections' all contribute to the regulatory scheme in the sense that they go some way towards locating accountability and risk across the system and, crucially, imposing on the entity playing the pivotal role a matrix of accountabilities that together earn it the characterisation 'trustee.'

The formal state-sponsored elements of the regulatory scheme, including the statutory regime centred on the *Superannuation Industry (Supervision) Act* and the government's regulatory agencies, APRA, ASIC and the ATO, are imposed upon and operate alongside these privately negotiated 'meta-connections.' To be effective they must engage with them in a nuanced and carefully targeted way. If not, the dialectical and cautelary processes of private markets and their participants will contract around the statutory measures in pursuit of their own ends.

What emerges from this complex tapestry of rules is a truly ‘inter-legal’ regulatory scheme. The private market and state-sponsored elements of the scheme co-exist but their interaction is multi-faceted and complex. In some places the private elements prevail, in others statute is more prescriptive, but in many areas the elements combine in a complementary way, buttressing or informing each other. The ways in which this happens, and the consequences in substantive terms of this interaction have been a major theme of this Thesis. At one level, therefore, this Thesis has been concerned to analyse and illustrate how the different strands of the regulatory scheme combine to impose a matrix of accountabilities on the pivotal participants in the system, the trustees of the superannuation funds.

The Role of Trust Law in the Regulatory Scheme

The primary objective of this Thesis has however been to map and assess the role of trust law in the regulatory scheme shaping the superannuation system in Australia in the context of the complexity and dynamism present in the system. It has found that trust law has provided an effective infrastructure for the system, enabling the system to provide a means by which individuals can accumulate assets to assist in funding their expenditure in retirement. It has also found that trust law supports the regulatory objectives of economic efficiency and member protection. That support is quite specific in certain respects, especially those related to the quality of conduct expected of trustees in respect of which trust law imposes often quite exacting requirements. In other areas, especially those related to economic efficiency, trust law is more accommodative, giving private market modalities the opportunity to impel the system towards efficiency rather than providing that impetus itself.

The analysis presented in this Thesis identifies that trust law plays a crucial role in providing an infrastructure for the superannuation system. The elements of equitable doctrine that combine to constitute ‘trust law’ define a set of generic, negotiable obligations from which emerges the trust model, and, crucially, the figure of the trustee. In identifying a single party, the trustee, on whom members can rely and on whom regulators can focus, trust law provides an institutional blueprint for the key institution in the system. This is trust law’s infrastructure role.

Trust law's role extends beyond that infrastructure role, however. The jurisprudence surrounding key concepts and phrases in trust law is available to assist in the interpretation of key statutory provisions, such as the s52(2) covenants. This enables the statutory regime to harness both the substance of trust law and its cognitive structure, its connection with evolving expectations in respect of concepts such as care, diligence and prudence. This is trust law's interpretive role.

This contribution, moreover, extends beyond the express provisions of either statute or the arrangements privately negotiated. Trust law's reliance on principles gives it the ability to supply substantive content in respect of issues not adequately addressed elsewhere in the regulatory scheme. This default role is not so extensive as to constitute a comprehensive 'safety net' for the regulatory system, but it does materially extend its application, most especially in relation to issues such as impartiality and conflicts of interests where the statutory scheme is *sotto voce*, if not silent.

Finally, trust law's contribution extends beyond the formal operation of the legal system in so far as it encourages a culture of superannuation fund trusteeship in which a member-prioritising orientation and norms of care and diligence, in particular, are prominent. This is its normative role.

This nuanced and multi-faceted understanding of the role played by trust law stands in contrast to earlier analysis in the field. Government reviews in Australia and the UK have repeatedly endorsed trust law as the legal architecture for the superannuation (pension) system.[1] However they have done so with relatively little explanation of why such a choice was made. Commentators, too, have considered the strengths and shortcomings of trust law in the superannuation (pensions) context, in some cases concluding that despite the rhetoric in which it is articulated, trust law is vulnerable, at best, and perhaps even hopelessly deficient, in actually protecting members against inefficient self-interested or incompetent trusteeship.[2]

This Thesis is a counter to such pessimism. It supports the conclusion that trust law has an important role to play in the regulatory scheme. The analysis presented in this Thesis

1 See discussion in Chapter 4, above.
2 See discussion in Chapters 2 and 4, above.

demonstrates that trust law is deeply integrated into the regulatory scheme. It contributes in a number of ways; the four roles described in Chapters 4 to 7. But the contribution has another dimension. Trust law contributes substantively also. It contributes alongside contract and statute to a matrix of accountability that distributes the incidence of loss between participants in the system. It thus plays a role within the regulatory scheme in determining who bears the consequences in any particular set of circumstances for the realisation of an undesirable outcome. The inter-legality between trust law and other elements of the regulatory scheme thus spans both instrumental and substantive dimensions.

This more detailed, nuanced and complex description of the role played by trust law provides an opportunity for policy makers in the future to recognise some of the more subtle aspects of that role, and the consequences that flow from those subtleties. Moreover, and importantly in the current context, the description demonstrates that trust law's critics have underestimated and misconceived the role played by trust law in relation to the member protection objective. The sentimentality present in many accounts of trust law's role obscures the contribution actually made by the 'trust model'. Trust law is not monotonically protective of beneficiaries. This is true, too, in the superannuation context. It maintains the interests of the parties in a finely and deliberately calibrated balance that has been honed and re-calibrated by the courts over time. As we have seen, there are circumstances in which beneficiaries, and by extension the members of superannuation funds, can expect the protection of trust law, but equally there are circumstances, such as in relation to beneficiaries' ability to contest exercises of a trustee's discretion, where trust law affords far less protection.

This should not be taken to imply that trust law's contribution to the regulatory scheme is beyond criticism. This Thesis has identified a number of areas where trust exposes the regulatory scheme to undesirable risks. Paramount amongst these is the ability of key prescriptions and proscriptions of trust law to be sidestepped by opportunistic drafting of the trust instrument. Although both trust law and the statutory regime limit the extent to which the trust instrument can limit or exclude these protections, there remains the risk (which has been substantiated in practice) that structures can be designed that have the effect of conditioning the application of the rules, or indeed bypassing them altogether.

Other examples identified in the analysis include the way in which its reliance on principles rather than rules gives it the appearance of imprecision and a lack of taxonomic tidiness. These act as a partial counterbalance to the advantages of principles in a regulatory setting; their ability to accommodate diverse fact settings, their focus on substance and quality rather than form and the way they transfer some of the responsibility for interpretation of the requirement to the subject of the regulation.

The overall conclusion reached in this Thesis is thus that trust law makes an important but limited contribution to the regulatory scheme shaping superannuation. It supplies rules to the regulatory scheme expressly, implicitly and by default. In addition, its exhortative character inspires normative compliance on the part of trustees that promotes an overarching regulatory concern for member protection. Finally and, perhaps most importantly, it effects a distribution of responsibility (and correlatively, risk) across participants in the system that contributes to the achievement of two key regulatory objectives: efficiency and member protection.

Future Directions

This Thesis has advanced a more elaborate and sophisticated description of the role played by trust law in the superannuation system than has been present in accounts of the regulatory scheme until now. It has suggested that that role is much more intertwined in the statutory scheme and that trust law's substantive contribution is more nuanced than is usually recognised. In widening the typical scope of analysis from analysis of a particular rule or a particular phenomenon, this Thesis has suggested that context is critical. Focussed analysis of particular rules is vital to understand precisely the substantive content of those rules, but often the way in which the rules interact, and the responses of those subject to the rules, is equally important. A prohibition on conflicts of interest will be ineffective if the key decision-makers owe no direct duty to beneficiaries, for instance. Similarly a requirement that trustees set an appropriate investment strategy for members is undermined if there is ambiguity around who is accountable when the member exercises investment choice. It is to be hoped that this Thesis will inspire greater recognition of the crucial importance that analysis of reflexivity, interdependence and context-relevance ought to play in the evaluation of regulatory regimes.

There are other areas in which this Thesis highlights that there is still work to be done. One very obvious example is the link, posited in Chapter 7 but not empirically established, between the language and substance of trust law and the belief systems of the individuals serving on trustee boards. Another is the apparent dissonance between the requirement for equal member and employee representation and the increasingly exacting standards of competence and independence expected of trustee board members: is that dissonance a consequence of the legal requirements or perhaps even based on a flawed understanding of an empirical reality in which the level of education and technical training in superannuation is not materially different as between different cohorts of board members?

Finally, one question this Thesis has not asked is whether the trust is the best foundation on which to build the superannuation system. Clearly it is only one of many legal institutions that could play the role. It would be possible to employ corporate or insurance-based structures, for instance. Or perhaps a bespoke statutory creation could be crafted. The analysis in this Thesis could contribute to such a debate because it maps more comprehensively than ever before exactly what role trust law does play. It has also identified the major weaknesses of trust law, and the way in which other strands of the regulatory tapestry have been enrolled to compensate for those weaknesses. Perhaps most importantly, though, it has identified that the claims of any alternative legal structure must be measured against the regulatory objectives and purpose of the system. It must also be able to work in combination with other elements of the system. Therefore the question of which legal institution is best cannot be evaluated in isolation, nor in response to a narrow misgiving about trust law's ability to deal with a particular empirical phenomenon. It must be evaluated in light of the complexity and dynamism of the system in which it will be employed, and which, in turn, it will help shape. It must, in other words, demonstrate that it has the flexibility, potency and resilience already demonstrated by trust law.

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