Law Council
OF AUSTRALIA

10 April 2015

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: fsi@treasury.gov.au

Dear Sir/Madam

Financial System Inquiry Final Report

I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia.

The Committee would welcome the opportunity to discuss the submission further. In the first instance, please contact:

- Ms Michelle Levy, Chair, Superannuation Committee Tel: 02 9230 5170
  Email: michelle.levy@allens.com; or

- Mr Tony Nemec, Chair, Legislation and Policy Subcommittee Tel: 02 8864 6974
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Yours sincerely

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OF AUSTRALIA

Financial System Inquiry Final Report and Recommendations

Financial System and Services Division

The Treasury

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

10 April 2015

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Introduction

1. This submission was prepared for the Law Council of Australia by the Superannuation Committee of the Legal Practice Section. The objectives of the Superannuation Committee are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

2. The Law Council of Australia is the peak national representative body of the Australian legal profession and represents 60,000 legal practitioners nationwide. Attachment A outlines further details in this regard.

3. This submission responds to the Treasury primarily to recommendation 13 'Governance of superannuation funds' of the *Financial System Inquiry Final Report* (2014).

4. Recommendation 13 provides:

   Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements. (emphasis added)

5. This submission recommends:

   (a) removing the current limits on the appointment of independent directors to standard employer-sponsored funds under s 89 of *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act);

   (b) removing the voting restrictions on independent directors;

   (c) that the policy rationale for the appointment of independent directors be better articulated so that the attributes of an 'independent director' can be clarified to assist with the development of an appropriate definition;

   (d) that the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) be amended as an interim measure to permit the appointment of more independent directors with full voting rights to public offer standard employer-funds;

   (e) that the proposed "alignment" of directors' penalty provisions under the SIS Act with managed investment schemes (MIS) be reconsidered. Such a measure would in fact extend superannuation directors overall liability exposure beyond that for directors of a MIS and is unduly onerous in the context of the greater liability exposure already imposed on superannuation trustee directors as part of the recent "Stronger Super" reforms.

Majority of independent directors – need for interim and transitional relief

6. If recommendation 13 is to be accepted by the Australian Government, s 89 'Basic equal representation rules' of the SIS Act will need to be amended.

7. To facilitate an orderly transition to any new mandatory requirement for a majority of independent directors to be appointed to public offer standard employer-sponsored funds, we suggest that consideration be given in the interim to:

- removing the current limits on the appointment of independent directors to those funds under s 89 of SIS Act; and

- removing the voting restrictions on independent directors.

8. The Australian Prudential Regulatory Authority (APRA) is understood to already permit a number of standard employer-sponsored funds to appoint up to one-third of independent directors consistent with s 89.

Definition of "independent director" of a super fund and interim relief

9. The question of how an independent director should be defined is currently in debate, with the current SIS Act definition not necessarily appropriate for today. The FSI suggested that an independent director should be "at arm's length"[1] which does not provide sufficient definitional certainty for industry participants and the regulator, and is more appropriate to use as a legal criteria in relation to contracting requirements rather than director eligibility criteria.

10. 'Independent' can mean different things for different purposes. For example, for an ASX listed company, independence from management is important, whilst for a super fund trustee it may mean independence from service providers, related bodies corporate and other funds.

11. The Law Council suggests that the policy rationale for the appointment of independent directors warrants further consideration and articulation as this will assist in defining the attributes that are required for a director to be 'independent'.

12. Similarly, removing the current restriction on the number of independent directors is suggested as an interim measure that can be implemented by statutory amendment now, while the more complex definitional issues are being resolved.

Aligning the director penalty regime with Managed Investment Schemes – reconsideration required

13. The Law Council does <u>not</u> agree with the FSI recommendation that the SIS Act director penalty regime should be "aligned" with MIS or considered in isolation from the other liability exposure of such directors. To do so appears unnecessary given the extended liability exposure of superannuation fund trustee directors as a result of the recent "Stronger Super" reforms. The proposal would expose superannuation trustee directors in practice to greater (rather than "aligned") overall liability exposure for breach of their duties than directors of a MIS. If the proposal is adopted, a breach of the superannuation fund director covenants would expose a director to both:

    (a) direct liability to individual members for loss arising from a breach of the covenant (unlike a director of a MIS); plus

    (b) liability for civil penalties.

14. If such an onerous exposure were to be imposed on superannuation trustees, this may well detract from the feasibility of implementing the FSI recommendation for a majority of independent directors on public offer superannuation fund boards. It is difficult to

[1] Australian Government, The Treasury, *Financial System Inquiry Final Report*, November2014, p 133.

envisage highly skilled professional directors being willing to assume such levels of exposure to liability.

Detailed comparison

15. The penalty regime for managed investment schemes is constructed differently than that operating under the SIS Act. Under Chapter 5C of the *Corporations Act 2001* (Cth), a breach of a director's statutory duties is a civil penalty provision.[2] In addition, an intentional or reckless breach of a director's statutory duties is an offence carrying 2000 penalty units, 5 years' imprisonment or both.[3]

16. However, under the managed investment scheme regime, directors of a responsible entity (RE) have no direct liability to individual scheme members for a breach of their statutory duties.

17. Rather, once the court makes a declaration that a civil penalty provision is breached, the Australian Securities and Investments Commission (ASIC) can seek both a pecuniary penalty (up to $200,000 payable to ASIC) if the breach is serious and materially prejudices the interests of the scheme or its members. In addition, the court may order compensation to be paid to the scheme on application by the responsible entity.[4]

18. As such, there is no direct civil liability to members of the scheme. Instead, if a court finds that an RE director has breached his or her statutory duties, the court may award compensation to the scheme (but not to individual scheme members).

19. Under the SIS Act there is civil liability for loss (owed directly to members) for breach of a covenant. This means that a superannuation director could be sued by an individual member or by a class of members who allege that they have suffered loss as a result of a breach of covenant.[5] However, breach of a SIS Act director covenant is not itself a civil penalty provision and therefore a pecuniary penalty cannot be sought by APRA for breach. Superannuation trustee directors can be deemed to have breached a civil penalty provision if they are involved in a contravention of a civil penalty provision by the trustee. Hence superannuation trustee directors already do have exposure to civil penalties, just not for penalties as a result of a breach of their own personal director covenants.

20. If the FSI recommendations are adopted in relation to the SIS Act director covenants, superannuation trustee directors will have not only direct civil liability to members for loss (and exposure to class actions as at present) but will also face the prospect of pecuniary penalties payable to the regulator and criminal sanctions for intentional or reckless breach of the covenants.

21. If the Government does want to impose pecuniary penalties exposure for breach of the SIS Act director covenants, then we believe that it should align all aspects of the SIS Act liability regime with the managed investment scheme regime by, at the same time, removing the direct liability to members that superannuation directors currently have. In other words, fund members would no longer be able to sue a director personally, but rather any compensation would be awarded by the court on application by the trustee and such compensation would be payable to the fund.

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[2] These duties also apply to other 'officers' of the RE: see s 601FD *Corporations Act 2001*.
[3] Section 601FD and Schedule 3 Penalties *Corporations Act 2001.*
[4] As with the SIS Act, there are powers for the court to give judicial relief to persons who have acted honestly and ought fairly to be excused having regard to all the circumstances.
[5] This threat of class actions is already a deterrent and many professional directors are seeking extensive indemnities before they are prepared to assume office.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12-month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2015 Executive are:

- Mr Duncan McConnel, President
- Mr Stuart Clark, President-Elect
- Ms Fiona McLeod SC, Treasurer
- Dr Christopher Kendall, Executive Member
- Mr Morry Bailes, Executive Member
- Mr Ian Brown, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.