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## Submission to the Treasury's consultation on legislating the objective of superannuation

The Australian Treasury is seeking stakeholder feedback on its proposed draft objective of superannuation: "The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way".

In general, the authors of this submission are supportive of an approach to legislate the purpose of superannuation. The comments below provide further reflections on the scope of the proposed purpose, particularly from our expertise as climate change researchers. This submission responds to each of the questions included in the Consultation Paper (Part A) and includes background information on superannuation fund trustees duties (Part B).

This submission is authored by academics at the University of Melbourne, and is coordinated by the Melbourne Climate Futures (MCF) initiative. MCF brings together academics from across all disciplines at the University, to develop evidence-based and practical solutions to climate related challenges. In 2023, MCF will launch a Sustainable Finance Hub which will, inter-alia, conduct research on the role of institutional investors in the clean energy transition.

### Part A: Responses to questions raised in Consultation Paper

#### Question 1

What do you see as the practical benefits or risks associated with legislating an objective of Australia's superannuation system?

Previous Australian Government inquiries and initiatives have highlighted practical benefits that may flow from legislating the purpose of superannuation. These practical benefits have included the following:

#### Financial System Inquiry 2014

- Providing a framework to evaluate the efficiency and effectiveness of the superannuation system.

- Providing confidence and stability in the system through agreed objectives.

#### Superannuation (Objective) Bill 2016

- Ensuring future policy is guided by clear objectives.
- Providing a framework to measure and evaluate policy proposals and future changes in the superannuation system.

#### Retirement Income Review 2020

- Steering the direction of future policy initiatives.
- Ensuring the purpose of the system is understood by the public.
- Providing a framework to assess the performance of the superannuation system.

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In addition, legislating the objective of superannuation might enhance a purpose-based approach to governance by superannuation fund trustees by specifying further objectives for the superannuation system. By governance, this submission refers to “the framework of rules, relationships, systems and processes within which, and by which, authority is exercised and controlled within entities”.<sup>1</sup> Purpose-focus governance sees governance as connected to, and informed and shaped by the purposes of the entity.<sup>2</sup> This may open up new and beneficial approaches to decision-making.<sup>3</sup> For example:

- Purpose can inform how beneficiaries’ interests are understood and interpreted, and encompass a broader understanding than just financial interests. This might include a longer-term perspective that goes beyond the interests of individual beneficiaries and connects decision-making to broader social purposes like addressing climate change.
- A purpose-focus can establish parameters that inform how trustees ought to act. This includes, for example, how trustees undertake their investment duties, emphasising a longer-term perspective that recognises the need to invest in a safer climate future.
- Purpose can also shape and form the basis for the culture, values and decision-making by superannuation fund trustees. This might enhance confidence and consistency in trustee decision-making by aligning responsibilities with the broader purpose of superannuation.

A purpose-focused approach to superannuation fund trustee governance is arguably premised upon a broader understanding of the legal relationship between trustee and beneficiary. This reflects contemporary sentiment that a significant proportion of Australians expect their bank savings and superannuation to be invested responsibly and ethically and to have a positive impact on the world.<sup>4</sup> It also resonates with the position of the Treasury in the Consultation Paper that “[t]here is significant opportunity to leverage greater superannuation investment in areas where there is alignment between the best financial interests of members and national economic priorities,

particularly given the long-term investment horizon of superannuation funds”.

This view sees superannuation as a purpose-oriented arrangement under which assets are held and managed in stewardship. The UN-supported Principles for Responsible Investment (PRI), for example, defines stewardship as “the use of influence by institutional investors to maximise overall long-term value including the value of common economic, social and environmental assets, on which returns and clients’ and beneficiaries’ interests depend”.<sup>5</sup> Asset management is therefore connected to broader social, environmental and economic purposes, including the need to respond to climate change. Moreover, broadly diversified superannuation funds are inherently reliant on the overall health of the environment, society and economy, and so investing in that overall health is consistent with individual beneficiaries’ interests. This effect increases with the size and diversity of the super fund concerned.

However, the potential benefits of legislating the objective of superannuation and enshrining a purpose-focus approach to governance should also be considered in light of possible risks. In particular, there will be a need to ensure that there is coherence between the legislated purpose of superannuation and existing superannuation fund trustee duties. While the Consultation Paper says that the legislated objective is not intended to impact trustees’ obligations, the authors of this submission are not sure whether this will be the case, given that duties are determined (among others) by the provisions of the relevant constituent documents of the trust. Rather, we suggest that a more coherent approach might come from further considering whether the legislated purpose (which makes explicit reference to, amongst other things, sustainability) might inform trustees’ duties to act in accordance with the terms of specific trust instruments and their duties to beneficiaries. This issue is considered in more detail under Question 3 below.

<sup>1</sup> These advantages are adapted from Rosemary Teele Langford’s assessment of a purpose-based model for corporate governance, rather than superannuation fund trustee governance in particular: Rosemary Teele Langford, ‘Purpose-Based Governance: A New Paradigm’ (2020) 43(3) *UNSW Law Journal* 954, 955.

<sup>2</sup> Ibid 956.

<sup>3</sup> Ibid 957–958.

<sup>4</sup> Z Banhalmi-Zakar and E Parker, *From Values to Riches 2022: Charting Consumer Demand for Responsible*

*Investing in Australia* (Responsible Investment Association Australasia, 2022) 6.

<sup>5</sup> *About Stewardship* (Principles for Responsible Investment, 2023)

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## Question 2

Does the proposed objective meet your understanding of the objective of the superannuation system in Australia?

The authors of this submission are commenting on the use of the term “sustainable” in the proposed wording of the objective. We suggest that the purpose of superannuation (and specifically the term “sustainable”) might reflect both the impact of climate change on superannuation and the impact of superannuation on climate change. As put in the Consultation paper, the purpose is “to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and *sustainable* way” (emphasis added). The Consultation Paper elaborates that “sustainable” signifies “that the system should be robust to demographic, economic and social change, and should be cost-effective for taxpayers in achieving retirement outcomes”.

To elaborate, climate change are already creating and will continue to create financial risks for superannuation funds. These financial risks may come from physical risks that are associated with weather events (acute) or longer-term shifts in climate patterns (chronic), and transition risks that come from rapid policy, legal, technology, and market changes adopted to mitigate and adapt to climate change.<sup>6</sup> Emerging work also suggests that increasing climate-related legal actions create separate risk transmission channels for institutional investors.<sup>7</sup> In addition, climate change potentially poses a systemic risk to the stability of the overall financial system.<sup>8</sup> These physical, transition and systemic risks will have increasing financial consequences for superannuation fund trustees, and consequently their beneficiaries, as climate change impacts increase. This includes affecting assets and liabilities (especially long-term assets), and changing the organisation of capital and financing. For example, the value of assets may be impacted by the physical impacts of climate change like changing rainfall patterns, flooding, drought, heat stress and rising sea levels, and fossil fuel investments become at risk of asset stranding with the transition to a net zero economy.

In addition, and in the alternative, superannuation fund investment can also have an impact on the climate problem. In Australia, superannuation fund trustees currently have a duty to act in the best financial interests of beneficiaries when exercising their responsibilities to

invest trust funds. This is a significant source of finance, with these assets totally \$3.4 trillion at the end of 2022. Superannuation might therefore play an important role in providing the investment to support the transition to a clean energy future and to build resilience to climate change impacts where this is in beneficiaries’ long-term interests, for example, because of the impacts of climate change on the broader economy and the diversified holdings of superannuation funds.

The authors of this submission therefore suggest that the purpose of superannuation, specifically the term “sustainable”, might be interpreted to reflect the dual relationship between climate change and superannuation. In particular, the impact of climate change on investments needs to be considered, and superannuation investment aligned with a sustainable future to the extent possible and where there is consistent with beneficiaries’ interests, the duties of trustees and terms of the trust deed.

## Question 3

Is the proposed approach to enshrining the objective in legislation appropriate? Are there any alternative ways the objective could be enshrined?

The authors of this submission are generally supportive of the proposed approach to enshrining the objective of superannuation in legislation. In particular, we suggest that this might give further depth to current understandings of superannuation fund trustees’ duties. For example, the legislated purpose of superannuation may inform trustees’ duties of care, skill and diligence in s 52A(2)(b) and (f), 52(2)(b), (i) and (j) of the *Superannuation Industry (Supervision) Act 1993* (Cth). It may indicate to trustees that they should consider, alongside other factors, the impact of climate change on superannuation and the role of superannuation in responding to climate change impacts in fulfilling these duties. In this regard, legal opinion has already identified climate change as a factor to be taken into account in satisfying trustee duties. As suggested by Hutley and Mack, “it is incumbent upon a trustee director, in an appropriate case, to consider the climate change risk in order to satisfy the requirements at s 52A(2)(b) in relation to due care, skill and diligence, s 52A(2)(c) in relation to the best interests of beneficiaries and at s52A(2)(f) in relation to ensuring a corporate trustee carries out the s 52 covenants”.<sup>9</sup>

<sup>6</sup> Task Force on Climate-Related Financial Disclosures, *Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures* (June 2017) 5–6 <<https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>>.

<sup>7</sup> Bank of England, *Results of the 2021 Climate Biennial Exploratory Scenario (CBES)* (24 May 2022).

<sup>8</sup> Patrick Bolton et al, *The Green Swan: Central Banking and Financial Stability in the Age of Climate Change* (Bank for International Settlements, 2020) <<https://ideas.repec.org/b/bis/bisbks/31.html>>.

<sup>9</sup> Noel Hutley and James Mack, *Memorandum of Opinion: Superannuation Fund Trustee Duties and Climate Change*

However, the authors of this submission suggest that further consideration be given to making it clear that the duties of trustees be interpreted in a way that is consistent with the proposed statutory objective, which makes explicit reference to, amongst other things, sustainability. In particular, trustees in Australia are required to perform their powers and exercise their duties in the “best financial interests” of beneficiaries: ss 52(2)(c) and 52A(2)(c). Some case law has questioned the extent to which ethical and social objectives can be used to guide the exercise of these investment powers where this is not provided for in the terms of the trust instrument. These cases have emphasised the need for trustees to act in the best financial interests of beneficiaries (see *Cowan v Scargill* and *Harries v The Church Commissioners for England*). This is not necessarily problematic if climate change “presents a potentially material financial risk or opportunity for a fund, its operations or investments [including] the longer-term time horizon inherent in the function of its funds as vehicles for retirement savings”.<sup>10</sup>

Yet, it is possible to imagine situations where climate friendly investment might not necessarily be in the best immediate financial interests of beneficiaries. For example, this might be the case where there may be short-term financial gains to be had by investing in fossil fuel entities, although this minimises the longer-term interests of beneficiaries and society more generally in a healthy and sustainable climate future. Indeed, while superannuation funds are increasingly offering sustainability products as a way for members to express their non-financial interests, there is little available evidence that this voluntary measure is sufficient to ensure beneficiaries’ interests are safeguarded from longer term risks with financial consequences, such as climate impacts.

As such, the authors of this submission suggest that there may be further consideration given to making it clear that the duties of trustees, including the duty to act in the financial best interests of members, should be interpreted

in a way that is consistent with the statutory objective and its reference to “sustainable”.

There may also be a need to reflect on the coherence between the legislated purpose of superannuation and the conflict provisions in the *Superannuation Industry (Supervision) Act 1993*. These provisions require trustees to privilege the interests of beneficiaries over others in the instance of conflicts: see s 52A(d) and (e), 52(2)(d), (e), (f) and (h). It is important to note here that the authors of this submission are not suggesting that trustees should not prioritise the interests of beneficiaries. However, we are suggesting that superannuation may be considered as a stewardship arrangement where there is some connection to broader social purposes. The authors of the submission therefore suggest that the interests of beneficiaries may be understood in a broader context where they are connected to the interests of society at large in a safer climate future, whether on a financial basis through universal ownership or as a result of ethical considerations of investors not wanting to be complicit in environmental harms.<sup>11</sup>

#### Question 4

What are the practical costs and benefits of any alternative accountability mechanisms to the one proposed?

The authors of this submission do not have specific comments in relation to this question other than to note that the costs of climate damage to the Australian economy far outweigh costs that might be incurred in the short term by superannuation funds to build capability to understand and account for climate impacts in their investment decisions.

## Part B: Background information

Trustees powers and duties in Australia derive from the trust instrument, in statute and in equity. This includes broad power to invest trust funds enshrined in State legislation. For example, s 5 of the *Trustee Act 1958* (Vic) provides that “a trustee may, unless expressly prohibited by the instrument creating the trust– (a) invest trust funds in any form of investment; and (b) at any time, vary an investment”. More relevant to this consultation, trustees and directors of corporate trustees are also bound by covenants set out in ss 52 and 52A of the *Superannuation Industry (Supervision) Act 1993* (Cth). These include:

*Risks* (Market Forces, 15 June 2017) 5  
<[https://www.envirojustice.org.au/sites/default/files/files/20170615%20Superannuation%20Trustee%20Duties%20and%20Climate%20Change%20\(Hutley%20%26%20Mack\).pdf](https://www.envirojustice.org.au/sites/default/files/files/20170615%20Superannuation%20Trustee%20Duties%20and%20Climate%20Change%20(Hutley%20%26%20Mack).pdf)>.

<sup>10</sup> Sarah Barker et al, ‘Climate Change and the Fiduciary Duties of Pension Fund Trustees – Lessons from the Australian Law’ (2016) 6(3) *Journal of Sustainable Finance & Investment* 211, 218.

<sup>11</sup> Banhalmi-Zakar and Parker (n 4) 6.

## Section 52

(2) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:

- (a) to act honestly in all matters concerning the entity;
- (b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments;
- (c) to perform the trustee's duties and exercise the trustee's powers in the best financial interests of the beneficiaries;
- (d) where there is a conflict between the duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee:
  - (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
  - (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
  - (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
  - (iv) to comply with the prudential standards in relation to conflicts;
- (e) to act fairly in dealing with classes of beneficiaries within the entity;
- (f) to act fairly in dealing with beneficiaries within a class;
- (g) to keep the money and other assets of the entity separate from any money and assets, respectively:
  - (i) that are held by the trustee personally; or
  - (ii) that are money or assets, as the case may be, of a standard employer-sponsor, or an associate of a standard employer-sponsor, of the entity;
- (h) not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;
- (i) if there are any reserves of the entity--to formulate, review regularly and give effect to a strategy for their prudential management, consistent with the entity's investment strategies and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due;
- (j) to allow a beneficiary of the entity access to any prescribed information or any prescribed documents.

## Section 52A

(2) The covenants referred to in subsection (1) are the following covenants by each director of a corporate trustee of the entity:

- (a) to act honestly in all matters concerning the entity;
- (b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation entity director would exercise in relation to an entity where he or she is a director of the trustee of the entity and that trustee makes investments on behalf of the entity's beneficiaries;
- (c) to perform the director's duties and exercise the director's powers as director of the corporate trustee in the best financial interests of the beneficiaries;
- (d) where there is a conflict between the duties of the director to the beneficiaries, or the interests of the beneficiaries, and the duties of the director to any other person or the interests of the director, the corporate trustee or an associate of the director or corporate trustee:
  - (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
  - (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
  - (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
  - (iv) to comply with the prudential standards in relation to conflicts;
- (e) not to enter into any contract, or do anything else, that would:
  - (i) prevent the director from, or hinder the director in, properly performing or exercising the director's functions and powers as director of the corporate trustee; or
  - (ii) prevent the corporate trustee from, or hinder the corporate trustee in, properly performing or exercising the corporate trustee's functions and powers as trustee of the entity;
- (f) to exercise a reasonable degree of care and diligence for the purposes of ensuring that the corporate trustee carries out the covenants referred to in section 52.