PRI RESPONSE

TREASURY'S CONSULTATION ON LEGISLATING THE OBJECTIVE OF SUPERANNUATION

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PRI Association

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to Treasury's consultation on legislating the objective of superannuation.

ABOUT THIS CONSULTATION

On 20 February 2023, the Australian Government announced an intention to legislate the objective of superannuation with Treasury releasing a consultation paper seeking feedback on its proposed objective. The Government's proposed purpose in legislating an objective for superannuation is to create a shared understanding of superannuation's purpose across the accumulation and retirement phases, and provide stability and confidence to policymakers, regulators, industry, and the community by anchoring future policies affecting superannuation to a meaningful base. The proposed objective is as follows:

> "*The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way*.

The consultation paper notes that "*equitable and sustainable*" is used to signify that "*the system should provide similar outcomes for people in similar circumstances and government support should be targeted to those in need. Superannuation also needs to fit within the broader fiscal strategy*." It subsequently notes that "*sustainable*" is defined to mean that "*the system should be robust to demographic, economic and social change, and should be cost-effective for taxpayers in achieving retirement outcomes*."

Notably, Treasury have confirmed that the proposed objective would not change trustee obligations as it is separate from trustee's fiduciary duties and the sole purpose test. However, Treasury considers the proposed objective to be aligned with those obligations.

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KEY RECOMMENDATIONS

The PRI welcomes the Australian Government's proposal to legislate an objective for the superannuation system, which defines the purpose of superannuation, clarifies how superannuation should deliver on its purpose, and recognises the interaction of superannuation within other pillars of Australia's retirement system. A legislated objective for superannuation in Australia could help set a clear policy direction and ensure there is greater certainty for stakeholders within the superannuation system, including many of the PRI's Australian signatories.

Overall, the PRI is supportive of the proposed objective. However, there is one element of the definition, which we consider needs to be addressed to ensure that future policy developments made by reference to the objective are properly aligned with and reinforce superannuation trustees' fiduciary duties and emerging market practices relating to the consideration of sustainability-related risks and outcomes. In this respect, we consider that the relatively narrow definition of the term "*sustainable*" that is currently proposed needs to be adjusted to ensure that these considerations are properly reflected.

The PRI further highlights a risk that superannuation trustees' duties may be interpreted according to and confused with the proposed objective if the objective is legislated under the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act). Accordingly, we encourage the objective to be legislated in a new stand-alone act.

Addressing system-level sustainability-related risks and beneficiaries' objectives

We recognise that with this proposal, Treasury is seeking to ensure the superannuation system delivers income for Australians throughout retirement while providing broader benefits to the economy. We consider that these objectives are mutually reinforcing and are entirely consistent with current interpretations of superannuation trustees' duties and well aligned with emerging practices around beneficiaries' objectives.

Most Australian superannuation funds have highly diversified portfolios that effectively represent a slice of the overall market. While this level of diversification reduces financial risks from exposure to individual companies, it means investment returns are largely driven by the performance of whole sector and markets.[1] Accordingly, Australia's superannuation system is particularly dependent on economic growth over the long term, which itself relies on healthy environmental and social systems. Nevertheless, these systems are currently threatened by issues such as climate change, biodiversity loss, and rising inequality.[2]

As identified in detailed legal analysis recently published by the PRI and other partners, superannuation trustees' duty to act in their beneficiaries' best financial interests requires them to maintain and improve long-term financial performance by addressing both current and anticipated system-level risks.[3] To comply with their fiduciary duties, superannuation trustees must therefore consider the various sustainability-related system-level risks that threaten the financial interests of their beneficiaries over the long term. Where those risks are identified, they should also consider

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[1] PRI (2022), A Legal Framework for Impact: Australia.

[2] With regards to the economic impacts of climate change, see: IPCC (2022), Climate Change 2022: Impacts, Adaption and Vulnerability – Technical Summary.

[3] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making, PRI (2022), A Legal Framework for Impact: Australia.

taking steps to mitigate them, including by shaping sustainability outcomes that support the stability of environmental and social systems.

Additionally, evidence increasingly shows that individual investors want their investments to contribute to positive or reduce negative sustainability outcomes in the real world.[4] Research by the Responsible Investment Association Australasia, for example, shows that 80% of Australians expect their investments to have a positive impact on the world.[5] Therefore, to improve member satisfaction and outcomes, align with global best practice and reduce litigation risk and perceptions of greenwashing, investors globally, including a number of Australian superannuation funds, are increasingly responding to their beneficiaries' sustainability objectives by pursuing sustainability outcomes, consistently with their financial return objectives.

The proposed objective should be better aligned with trustees' duties and emerging market practices relating to sustainability risks and outcomes

The inclusion of the concept of sustainability within the proposed objective is both welcome and necessary to ensure alignment with both superannuation trustees' existing duties and beneficiary demands for superannuation funds to address their sustainability objectives. It is also well-aligned with the Government's stated intention to ensure that the benefits of the superannuation system for the economy and broader economic priorities are maximised.

However, the current definition of "*sustainable*" does not achieve the Government's intention given its overly narrow scope. Specifically, it has a narrow, reactive focus on how the superannuation system can maintain stability in response to economic, social, and demographic changes. Despite the explanatory text of the consultation paper, the definition of sustainable does not recognise the superannuation system's reliance on a strong and resilient economy, and the legitimate role of superannuation in delivering income in a manner that proactively supports and does not undermine the stability of the economy as well as the environmental and social systems upon which the economy relies.

Without recognising this broader concept of sustainability, legislating the current objective may lead to policy developments that are misaligned with trustee duties and that do not adequately account for or support the superannuation system to address sustainability-related system-level risks. Similarly, it may unintentionally limit future policy developments needed to support superannuation funds to respond to beneficiaries' demands and expectations regarding the extent to which their investments contribute to real-world, sustainability goals.

Further measures should be taken to avoid confusion about the relationship between the proposed purpose and trustees existing duties

Treasury have stated that the proposed objective is not intended to change trustee obligations as it is separate from trustee's fiduciary duties and the sole purpose test, but that nonetheless the proposed objective is intended to be aligned with those obligations. Despite this explanation and intention, inclusion of the proposed objective within the SIS Act, the object of which is to make provision for the

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[4] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.56-60); Fidelity International (2022). Fidelity survey: APAC investors' strong interest in sustainable investing continues, with a confidence challenge still to tackle.

[5] These expectations can drive investment behaviours with 61% of Australians stating they would save and invest more if they knew their savings made a positive difference in the world. See Responsible Investment Association Australasia (2022), From Values to Riches 2022: Charting consumer demand for responsible investing in Australia

prudent management of certain superannuation funds, could lead to confusion and misunderstanding regarding the relationship between the proposed purpose and trustees existing duties.

Recommendations

We therefore recommend that Treasury amend the definition of 'sustainable' to better take into account the superannuation system's reliance on a strong and resilient economy and the legitimate role of superannuation in delivering income in a manner that proactively supports and does not undermine the stability of the economy as well as the environmental and social systems upon which the economy relies.

Treasury should also introduce the objective of superannuation in a separate legislative instrument to the SIS Act to minimise risks of conflating the proposed objective with existing obligations upon superannuation trustees set out in the SIS Act.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of Treasury to ensure the superannuation system is sustainable and contributes to real world sustainability outcomes.

Please send any questions or comments to policy@unpri.org.

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