Law Council of Australia Superannuation Lawyers' Conference 2019

Current Thinking on the Sole Purpose Test

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1. For many commentators and industry participants, the Superannuation Round of the Royal Commission into Misconduct in the Banking, Financial Services, and Superannuation Industry promised to deliver something like a showdown between the competing business models, investment philosophies, and associations.[1] Indeed, nothing might better demonstrate the schism between retail and industry super funds than a debate around the application and utility of the 'sole purpose test'.

2. In the events which happened, the organisation to receive the most adverse attention was arguably the industry regulator. Section 62 of the *Superannuation Industry (Supervision) Act* (the **SIS Act**) is a civil penalty provision of long standing: s 193 SIS Act. It is the Australian Prudential Regulation Authority (**APRA**), rather than the conduct regulator, the Australian Securities & Investments Commission (**ASIC**), which has been responsible for policing compliance with the sole purpose test.

3. Yet APRA had never commenced proceedings for breach of s 62. Nor has it, in the last decade, required an enforceable undertaking. Instead, APRA was content to issue guidance notes[2] and lodge public submissions telegraphing its interpretation of the law. Those documents set out APRA's less exacting interpretation of the law than a literal reading of the section would impose, and in particular displayed a more accommodating attitude to the presence of "incidental advantages" in the exercise of a trustee's power. APRA asserted that incidental 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.[3]

4. But even on that analysis, were there no significant breaches warranting intervention and deterrence in all that time? The heated cross-fire between the retail and industry wings of the superannuation system suggested this seemed unlikely.

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[1] As someone who has straddled that divide in multiple ways over time, even my own loyalties promised to be tested (as an advisor to various trustees of industry and retail funds, as a trustee director of a corporate fund, and more recently, an industry super fund, and (like so many of us) at one stage a member of *multiple* funds).

[2] *Superannuation Circular No.III.A.4: The Sole Purpose Test* (Feb 2001).

[3] APRA Circular, at [34].

5. As will be seen, there appears to have been little appetite to challenge this status quo, which well-suited industry and retail funds alike, which were content to rely upon APRA's approach to interpretation and enforcement to order their affairs accordingly. Similarly, at least until the Royal Commission, there was little appetite to engage with ASIC's experience that the prohibition on use of member funds in s 68A of the SIS Act was impractically narrow. By contrast, the inevitability of disputes over eligibility for tax concessions seemed to best explain the Australian Taxation Office's prominence in the body of caselaw about what trustees (most often of SMSFs) – can (and cannot) do.[4]

6. No doubt the adequacy of APRA's traditional approach - prioritising prevention and rectification – will now be tested against this record in its Enforcement Strategy Review.[5]

What of the Statutory Test?

7. So then, what of the statutory test? It is couched in very broad terms; embracing a number of separate definitional elements warranting close attention from trustees.

8. It requires that the trustees of superannuation funds ensure that the fund is maintained solely for at least one of the 'core purposes' set out in the Act.[6] A fund may also be maintained for an 'ancillary purposes' in conjunction with a 'core purpose'.

9. It is a contravention of the sole purpose test for a superannuation fund to be maintained only for one or more of the ancillary purposes.[7]

10. The core purposes (s 62(1)(a)) are enumerated – they are the provision of benefits:

    - for each fund member upon that member's retirement,[8]
    - for each fund member on or after the member's attainment of an age not less than the age specified in the regulations[9] (currently 65 years of age[10]), or

[4] The ATO has also issued its own guidance: see Self-Managed Superannuation Funds Ruling SMSFR 2008/2.

[5] "APRA announces Terms of Reference for enforcement strategy review" (12 November 2018). Draft recommendations were due to be available to APRA Members by 28 February 2019 with the final Review to be presented to the APRA Members by 31 March 2019.

[6] SIS Act, s 62(1).

[7] SIS Act, s 62(1)(b)

[8] SIS Act, s 62(1)(a)(i).

[9] SIS Act, s 62(1)(a)(ii).

[10] Superannuation Industry (Supervision) Regulations 1994, reg. 13.18.

- to the legal personal representative and/or to the dependents of the member if the death occurred before retirement or the member reaching the age of 65.[11]

11. The ancillary purposes (s 62(1)(b)) are similarly spelt out – they are the provision of benefits:

- for each member on or after termination of employment,[12]
- for each member on or after the member's temporary or permanent cessation of work due to physical or mental ill-health,[13]
- to the legal personal representatives and/or dependents of a member who dies after retirement or after attaining the age of 65,[14] and
- as APRA approves in writing.[15]

12. As noted above, s 62 has mostly been applied in the SMSF context,[16] and only rarely in the context of large-scale superannuation funds.[17] It is commonly invoked to stop members from personally deriving benefits from the superannuation fund prior to retirement. Whether a trustee complies with sole purpose test is to be assessed objectively, and will turn on the particular circumstances of each case.[18] The sole purpose test and the associated standards, prohibit the use of concessionally taxed superannuation savings for purposes such as providing pre- retirement benefits to members, benefits to employer-sponsors or facilitating estate planning.

13. Thus, trustees have been restrained from:

- paying another superannuation fund's tax debt;[19]
- providing a family trust with capital to purchase a Swiss chalet used by a member and his family;[20]

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[11] SIS Act, s 62(1)(a)(iii).

[12] SIS Act, s 62(1)(b)(i).

[13] SIS Act, s 62(1)(b)(ii).

[14] SIS Act, s 62(1)(b)(iii)-(iv).

[15] SIS Act, s 62(1)(b)(v) (a category described by some as providing an "inbuilt flexibility" to widen the statutory requirement).

[16] *Sutherland v Woods* [2011] NSWSC 13

[17] *Re AMP Superannuation Ltd* [2011] NSWSC 1439 at [14].

[18] *Montgomery Wools Pty Ltd as Trustee for Montgomery Wools Pty Ltd Super Fund v Cmr of Taxation* [2012] AATA 61 at [102].

[19] Case 23/96 96 ATC 278.

[20] Case 43/95 (1995) 31 ATR 1067.

- paying inflated price for assets from employer-sponsor controlled by trustees of superannuation fund'[21]
- acquiring residential premises for collateral purpose of leasing premises to associate of fund, even where associate pays rent at market value.[22]

14. The sole purpose test was recently clarified by a unanimous Full Federal Court in *Aussiegolfa Pty Ltd (Trustee) v Cmr of Taxation* [2018] FCAFC 12:[23]

- The sole purpose test is an objective test. The subjective motivation of a controlling director is not to be confused with the purpose of the entity they may control.
- Arrangements that are on arm's-length terms should typically not contravene the sole purpose test.
- The word "benefit" in the sole purpose test refers to a financial benefit rather than a general "current day benefit" (such as providing accommodation to a relative).

15. In considering s 62, it is relevant to focus on the *purpose* for which a fund is maintained, rather than *effect* of particular transaction. As Steward J went on to explain, the section:

> "looks to the object of acts of maintenance of a fund on a yearly basis. If those acts have the sole object of achieving the core purposes and/or ancillary purposes, the provision is satisfied".

16. The sole purpose test, with the prescribed SIS investment restrictions, is supposed to ensure that the retirement income objective is paramount. In *Aussiegolfa Pty Ltd (Trustee) v Commr of Taxation* [2017] FCA 1525, the primary judge, Pagone J had explained that:

> "A high standard adopted by s 62 SIS Act as an important pillar to ensure that superannuation funds achieve the objectives of providing retirement benefits and not current day use or benefits"

17. Of course, the provision does not adopt such language as the criteria in s 62 imposing a "strict" or "high standard". As Steward J warned in his judgment reversing Justice Pagone's ruling on the sole purpose question, there is[24]

> "a danger that such descriptions can unduly influence the construction of a provision or its application to the facts".

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[21] *APRA v Derstepanian* [2005] FCA 1121

[22] ATO Decision Impact Statement interpreting *Aussiegolfa Pty Limited (Trustee) v Commissioner of Taxation* [2018] FCAFC 122

[23] Reversing A*ussiegolfa Pty Ltd (Trustee) v Cmr of Taxation* [2017] FCA 152.

[24] *Aussiegolfa Pty Ltd (Trustee) v Commr of Taxation* [2018] FCAFC 12 at [231].

Achieving Scale: Marketing, Corporate Hospitality & Sponsorship

18. That trustees set about to campaign for more members is an entirely rational, and arguably obligatory, measure, particularly in the face of regulatory scale requirements.[25] The method by which trustees do so – from advertising or marketing, to large scale corporate hospitality – naturally drew the attention of the Royal Commission.

19. In a 2006 submission to Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Structure and Operation of Superannuation Industry, APRA acknowledged the campaign expenditure, and reminded trustees of the need to assess the size and effectiveness of that expenditure.

> "In making an assessment about the benefits of a campaign for membership or the most cost-effective way to provide information to members, APRA also notes that a trustee should be able to demonstrate that the expenditure has been considered in the context of the specific circumstances of the fund and its current members. If advertising or marketing is being considered in order to obtain or maintain economies of scale, the trustee should be able to demonstrate a good understanding of the behaviour of the fund costs which it considers would be influenced by economies of scale. Often the main costs incurred by superannuation trustees are for outsourced administration and investment services and these costs may already reflect scale economies on the part of the service provider."

20. The Royal Commission examined in some detail the issue of marketing and corporate hospitality through an examination of the marketing and entertainment expenses incurred by Hostplus.[26]

21. The Commissioner found that Hostplus' yearly expenditure on marketing and entertainment was "significant".[27] Part of this money was spent on corporate entertainment, where Hostplus senior executives 'informally entertain current and prospective employers'.[28]

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[25] The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill* 2019 replaces the current 'scale test' with an 'outcomes test'. This will require trustees to assess whether their MySuper product is optimising member outcomes by effectively promoting the financial interests of their beneficiaries. The outcomes test will also be extended to choice products.

[26] Final Report, Vol 2, Case Study 8, pp 209-220. Hostplus is a profit-for-member industry super fund that was established in 1988 by the Australian Hotels Association and the Liquor, Hospitality and Miscellaneous Workers' Union (now United Voice). Most of its members work in the hospitality and tourism industries. As at August 2018, Hostplus had approximately $34.5 billion in funds under management and just over 1.1 million members.

[27] Report, Vol 2, p 212, at [8.2.1]. In the year ended 30 June 2017, Hostplus' marketing and entertainment expenses were $21.44 million; which had increased from $13.12 million in 2013.

[28] Including approximately $260,000 on corporate entertainment for employers to attend the Australian Open tennis competition in 2018.

22. Hostplus' CEO argued it was 'done for the right purposes' of retaining the default status of the fund for employers currently with Hostplus and to build brand awareness. Hosting employers at events such as the Australian Open was a way to establish and retain relationships that are 'absolutely critical in terms of retaining the default fund status … and therefore, retaining members". That is, the ultimate purpose of the entertainment spend was to grow and retain funds to take advantage of that scale.

23. The CEO argued that the high performance of the fund was not enough to retain default status, and that Hostplus loses approximately $500 million a year in rollovers to underperforming and high cost funds. He said:[29]

> Relationships are absolutely critical. And where you have – you may have one or two individuals ostensibly making default fund decisions on behalf of their entire workforce. Let me tell you, I don't like it. I don't like the fact that we lose default fund status or lose employers to other competitors, to poorer performing funds, high fee paying funds. It does not make any sense to me. So retention of defaults is absolutely critical. And unashamedly – unashamedly, we utilise, you know, entertainment, corporate hospitality, in order to strengthen the relationships we have with our employers. You need to do that.

24. The Commissioner accepted three matters as "context" to the conduct examined:

    (a) that Hostplus has been a high performing superannuation fund;

    (b) that Hostplus' members tend to be young and disengaged, with low superannuation balances, with the consequence that when a member does not act, their account balance would reduce after fees and charges (such as insurance premiums); and

    (c) that Hostplus' two sources of revenue were:

        (i) the administration fees collected from members; and

        (ii) the tax benefit received on members' insurance premiums, which in practice yielded Hostplus an amount equal to 15% of the insurance premiums paid by members. That benefit was forecast to reduce by reason of proposed legislation[30] and voluntary compliance with the Insurance in Superannuation Voluntary Code of Practice.[31]

25. Surprisingly, the Royal Commission did not engage with the question of whether these activities breached the sole purpose test. Given the apparent objective of growing the membership base and hence scale of the fund as sanctioned by APRA's interpretative guides, it might well have been thought that any suggested finding of breach would be

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[29] Transcript, David Elia, 14 August 2018, 4868; cited in Final Report, Volume 2, p 213.

[30] Requiring members with balances of less than $6,000, under the age of 25, or who had not made a contribution in 13 months, to 'opt-in' to insurance.

[31] Which provides that insurance cover must end if no contribution has been made within 13 months.

readily met by the trustee's calling in aid the defence provision (s 323 SIS Act) and or relief from any penalty (s 221). And because of APRA's inactivity, the availability of those options remained untested in that context.[32]

26. Was instead generated interest was the reason why the Royal Commission so quickly dismissing the notion that a different provision - s 68A of the SIS Act - might well have been breached. That the Commissioner so concluded was hardly surprising. The section's aim was to ensure employers, in selecting default fund for employees, were not induced into selecting fund that may cause financial disadvantage to employees when, but for inducement, may not otherwise select fund. It was seen as an "*important protection for employees' used to help 'get to a stage where it is employees who are making real decisions [about their superannuation] rather than their employers*".[33]

27. However, s68A proved to be a relatively narrow restriction in practice. It did not prohibit trustees supplying entertainment or other soft dollar benefits to employers *in the hope (but not 'on the condition')* that they would nominate the trustee's fund as default fund for their employees.

28. In June 2015, ASIC, as the regulator responsible for the general administration of s 68A, highlighted that proving that a benefit was provided 'on condition' that an employee join the fund "*could be difficult"* ie, the inducement is not simply linked to the employer's selection of the fund as a default fund, but also upon the employer's employee(s) joining the fund:[34]

> "We note that many of the "inducements" that may be offered, particularly those offered directly to members (such as fee reductions or better insurance benefits for members) are not inducements for the purposes of s68A of the SIS Act. Similarly, there are exemptions to allow certain "inducements" to be offered – such as loans to employers by banks on a commercial arms-length basis and clearing house facilities: see regulation 13.18A of the SIS Regulations.
>
> Based on our work to date and analysis of s68A, we are aware that proving that a benefit was provided "on condition" that an employee join the fund could be difficult. That is, the inducement is not simply linked to the employer's selection of the fund as a default fund. But also upon the employer's employee(s) joining the fund".

29. In August 2018, ASIC used its Submission to Productivity Commission's Draft Report *Superannuation: Assessing Efficiency and Competitiveness* to reiterate its position:

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[32] In *Olesen v Parker* [2011] FCA 1096; (2011) 85 ATR 387 at [72] the respondent's attempt to rely on the defences and obtain relief were rejected.

[33] Section 68A in its original form was inserted into the SIS Act in 2004 as an amendment to an amending Bill, *Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill* 2003 (Cth) – the so-called *'kickback amendment*'. Modelled on s 78 *Retirement Savings Accounts Act 1997* (Cth), it came into effect in July 2005 as part of Choice of Fund reforms,

[34] ASIC Senate Economics Legislation Committee, Answers to Questions on Notice, Budget Estimates, 15 June 2015.

> "There are some limited provisions regulated by ASIC that have the aim of ensuring that employers make good decisions by addressing possible conflicts of interest. However, in ASIC's experience (and as ASIC has publicly noted), these are of limited effect. In particular, the prohibition on inducements by RSEs to employers under s68A of the SIS Act does not result in the commission of an offence nor the subsequent imposition of a penalty, and only gives rise to the creation of a statutory right for an aggrieved individual to commence a civil proceeding for the recovery of losses."

30. Commissioner Hayne found it difficult to see how Hostplus' hospitality and other benefits to employers breached s 68A (because of the absence of conditionality).[35] Finding that benefits provided to employers by some funds unduly influence some employers' choice of default fund,[36] the Commissioner agreed with ASIC's submission that s 68A was 'ineffective'.[37] He recommended that section 68A(1) and (3) should be repealed and provisions made along the lines of the long-established electoral law prohibitions against bribing electors,[38] advocating that the redrawn provisions should hinge upon whether the conduct *would* induce, or could reasonably be *expected* to induce, a person's choice of default fund for their employees who have made no choice of fund.

31. Of interest was that proposals for such amendments had won only mixed support in retail trustees' submissions.[39] It was suggested to Hayne by Industry Super Australia that such a prohibition would disproportionately disadvantage industry super funds, who, unlike many retail funds, must operate without the benefit of established banking relationships with employers.[40] Even if that were so, Hayne did not seem to accept such a proposition, but in any event, he refused to accept that trustees should be permitted to attempt to influence employers' decisions "through irrelevant considerations".[41]

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[35] Final Report, Vol. 2, p 219.

[36] See Finding 9.5.

[37] Ibid., p 220

[38] *Commonwealth Electoral Act 1902* (Cth). Commissioner Hayne incorrectly cited s 176 in his Final Report. The correct section is s 326. See further *In the matter of an application by Andrew Green for leave to issue a proceeding* [2011] HCA 5 (Hayne J).

[39] Compare AMP submission at p4-5 ("it is necessary to make changes to s. 68A of the SIS Act as we strongly believe the prohibition on providing inducements to employers should be strengthened"), with the submission of Colonial First State Investments Limited and Avanteos (p. 10) ("While there may be some issues with the application of section 68A, CFSIL generally considers that section 68A works well in the current context. Accordingly, it does not advocate for any amendment to the provision. Further, conduct covered by the prohibition, or more particularly the expense underlying the conduct, should already be regulated by application of the trustee's existing statutory and general law obligations").

[40] Industry Super Australia Pty Ltd, Module 5 Policy Submission, 6 [21].

[41] Final Report, Vol 1., p 252.

32. Commissioner Hayne saw the reason there was any need to ensure that inducements are not offered in the first place was because of the role employers play in fund choices for their employees under Australia's default fund system:

> However, that should only be an interim solution. The only wholly effective way of dealing with employer inducements (and principal–agent issues involving employers more generally) is to remove employers from the process of selecting super products for employees.

33. Of course, any change to the arrangements for default accounts was clearly beyond the scope of his inquiry, and in the absence of change, the most he could say was that s 68A should be strengthened.[42]

34. Recommendation 3.6 was one of two recommendations to be promoted by the Government to the floor of the Parliament.[43] A further amended *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill* 2017 passed the Senate on 14 February 2019, and was reintroduced to the House of Representatives on 18 February 2019, after which the Parliament adjourned until the April Budget sessions without its passage completing. Presumably the measure will be passed before Parliament is prorogued for the May Federal Election.

35. The measure will apply to contraventions occurring on or after the day the Bill receives Royal Assent. It amends s 68A by repealing current subsections 68A(1) and 68A(3) and substituting with provisions that allow civil and criminal penalties to be imposed on the trustee of a super fund who uses goods or services:

- to influence employers to nominate the super fund as the default fund; or
- to influence employers to encourage their employees to nominate the fund as their choice of fund (no treating of employers).

36. It also places obligations on the trustee of a super fund or its associates prohibiting them from:

- providing goods or services (or at particular prices) to the employer or their associates; or
- giving discounts, allowances, rebates or credits in providing goods or services to the employer or their associates,

if that relevant action could reasonably be expected to influence the choice of fund for which the employer contributes superannuation for its employees or influences the

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[42] See Final Report, vol. 1, p 252 & Recommendation 3.6.

[43] See Treasurer Josh Frydenberg's Media Release: "Taking action on the Banking, Superannuation & Financial Services Royal Commission – Recommendations 3.6 & 3.7", 12 February 2019.

employer to encourage their employees to stay with the fund or become a member of the fund.

37. Similar obligations are also imposed on the trustee or its associates for refusing to provide goods or services to employers or their associates because it is reasonable to conclude that the refusal was done because the employer has not chosen the fund as the default fund or the employer has not encouraged their employees to stay with or become a member of the fund.

38. The new measure is to be enforced as a civil penalty obligation: s 68A(4). It will be ASIC (not APRA) to apply to the Court for a civil penalty order. If the Court finds that a trustee has contravened one of these civil penalty provisions, the Court must declare that they have contravened the provision, and may fine the trustee up to 2,000 penalty units.

39. A comparison between the old and new s68A is as follows:

68A Conduct relating to fund membership	**68A <u>Trustees must not use goods or services to influence employers</u>**
(1) A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not:	(1) A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not:
(a) supply, or offer to supply, goods or services to a person; or	(a) supply, or offer to supply, goods or services to a person<u>, or a relative or associate of a person</u>; or
(b) supply, or offer to supply, goods or services to a person at a particular price; or	(b) supply, or offer to supply, goods or services to a person, <u>or a relative or associate of a person</u>, at a particular price; or
(c) give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person;	(c) give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person<u>, or a relative or associate of a person</u>;
on the condition that one or more of the employees of the person will be, or will apply or agree to be, members of the fund.	<u>if that action could reasonably be expected to</u>: <u>(d) influence the choice of the fund into which the person pays superannuation contributions for employees of the person who have no chosen fund; or</u> <u>(e) influence the person to encourage one or more of the person's employees to remain, or apply or agree to be, a member of the fund.</u>

(3) A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not refuse:	3) A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not refuse to:
(a) to supply, or offer to supply, goods or services to a person; or	(a) supply, or offer to supply, goods or services to a person, or a relative or associate of a person; or
(b) to supply, or offer to supply, goods or services to a person at a particular price; or	(b) supply, or offer to supply, goods or services to a person, or a relative or associate of a person, at a particular price; or
(c) to give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person;	(c) give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person, or a relative or associate of a person;
for the reason that one or more of the employees of the person are not, or have not applied or agreed to be, members of the fund.	if it is reasonable to conclude that the refusal is given because: (d) the person has not chosen the fund as the fund into which the person pays superannuation contributions for employees of the person who have no chosen fund; or (e) the person has not encouraged one or more of the person's employees to remain, or apply or agree to be, a member of the fund.

40. The Supplementary Explanatory Memorandum to the amendments expressly linked the amendments to the Round 7 Hearings:

> 5.5 Evidence was given to the [Royal] Commission which showed that some large funds were spending significant amounts to maintain or establish good relationships with employers who are responsible for nominating the default fund for their employees. The Report highlighted the deficiencies in the current application of section 68A which prohibits funds from providing goods or services to employers on the condition that an employee will apply to become a member of the fund. This sets the bar for connecting the actions of the fund to the result of the employee joining the fund too high.

41. Despite the assertion in Supplementary EM that the amendments "*implements*" Recommendation 3.6, in fact they go further – and in other respects, it may be argued they do not go far enough.

42. The revamped s68A lowers the bar for connecting actions of funds: an 'influence' test is likely to be more easily breached than, say, a 'substantial purpose' test. The test is seemingly modelled on definition of conflicted remuneration in s963A of the *Corporations*

Act 2001 (Cth)[44] (about which there is still no caselaw to date) rather the electoral bribery provisions which Commissioner Hayne had championed.

43. The amendments appeared particularly to target union and employer-aligned industry funds, who have suggested providing hospitality to employers to win default fund mandates is required, because many operate without the benefit of established banking relationships with employers like for-profit retail funds. Indeed, the *Australian Financial Review* declared the new law the "Hostplus Clause". In response, Hostplus CEO David Ellis contended the amendments are also likely to capture retail funds where they offer to bundle default super with a range of benefits to employers, including discounts on overdrafts and insurance, or free financial advice.[45] He may well be right, in part depending on what happens to the exceptions to s 68A in regulation 13.18A. There is no blanket ban on cross-selling. The exemptions to (old) s 68A recognised that employers may be doing business with a financial institution that also offers them superannuation in addition to other products or services. But those exemptions reflect the narrower s 68A test; consistency with the revamped s68A would seem a more desirable course.

44. It is also not apparent why the revamped section has been limited to supply of goods or services. Section 326(1) of the *Commonwealth Electoral Act*, upon which Commissioner Hayne had recommended any amendment be modelled, provides that a person shall not ask for, receive or obtain, or offer or agree to ask for, or receive or obtain, *any property or benefit of any kind*, whether for the same or any other person, on an understanding that, inter alia, a vote, candidate or support will, in any manner, be influenced or affected. To similar effect, s 326(2) provides that a person shall not, with the intention of influencing or affecting a vote, a candidate, or support, give or confer, or promise or offer to give or confer, *any property or benefit of any kind* to that other person or to a third person. Property includes *money*: s 287.

45. Another model which Commissioner Hayne might well have canvassed (or at least, those drafting the amendments to s 68A) is to be found in the corrupting benefits law,[46] introduced by the *Fair Work Amendment (Corrupting Benefits) Bill 2017* in response to the Royal Commission into Trade Union Governance and Corruption.

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[44] Conflicted remuneration is any benefit, whether monetary or non-monetary, given to a financial services licensee, or their representatives, who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

[45] John Kehoe & Joanna Mather, 'Hostplus clause' to ban super funds 'treating' employers, *Australian Financial Review*, February 12, 2019.

[46] See now *Fair Work Act 2009* Part 3-7, Division 2.

46. This introduced discrete but overlapping new penalty offences directed at improving governance and financial transparency of registered organisations.[47]

47. That new law goes beyond good and services to capture 'benefits' which are defined widely[48] as any advantage and is not limited to property, and cash or in-kind payments, which is defined as a benefit that is in cash, any other money form, or goods or services.[49]

48. Helpfully, the corrupting benefits laws also specify what are the 'legitimate payments'[50] an employer may request, receive or obtain that are exceptions to the general prohibition, including:

    - benefits of nominal value (no more than 2 penalty units) for travel or hospitality during consultation, negotiation or bargaining,
    - token gifts, event invitations or similar benefits of nominal value[51] (less than 2 penalty units) given in accordance with common courteous practice among employers and organisations,
    - payments made at market value for goods and services supplied to an employer in the ordinary course of an organisation's business.

49. The Registered Organisations Commissioner has also published a helpful Fact Sheet and a very detailed Guidance Note providing worked examples. There is no transitional period for the new s 68A. Hopefully APRA will promptly develop similar guidance for superannuation trustees in time for the new laws to commence. In the meantime, trustees should establish policies and procedures, including risk controls and training, to manage the imminent introduction and ongoing compliance with s 68A.

"Political" advertising

50. Advertising is one of the major tools (together with mergers) that trustees can use to build scale. Trustees are increasingly using new ways of interacting with new and potential members (such as mobile phone applications and social media platforms). However, advertising of a 'political' (policy) nature might seem to be problematic in the context of the sole purpose test, particularly if it is not directly focused on gaining new (or retaining existing) members.

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[47] Explanatory Memorandum, *Fair Work Amendment (Corrupting Benefits) Bill 2017*, page (i).

[48] *Fair Work Act 2009*, s 536D(7).

[49] *Fair Work Act 2009*, s 356F(4).

[50] *Fair Work Act 2009*, s 356F(3).

[51] A 'nominal value' is less than $420: see *Crimes Act* 1914 (Cth), s 4AA (penalty unit is $210).

51. Debates about the proper limits on trustees using funds to advocate on particular policy issues is well known to charity law.[52] In that context, there is no general doctrine which excludes from charitable purposes "political objects"'. However, such objects may not contribute to the public welfare, a matter to be determined by reason of the particular ends and means involved, not disqualification of the purpose by application of a broadly expressed "political objects" doctrine'.

52. In the context of superannuation regulation, whether political advertising (in the sense of advertising which advocates a particular regulatory policy position) is consistent with the intention behind section 62 of the SIS Act was well tested by the "Fox and Henhouse" campaign by Industry Super Australia.

53. AustralianSuper argued that such public advocacy was consistent with the sole purpose test, "*provided that the advocacy is aptly directed to the maintenance or improvement of retirement benefits*". Similar formulations were proffered by supporting industry associations ASFA[53] and AIST,[54] acknowledging a need to demonstrate a connection with the superannuation purposes.

54. Uniformly, parties relied upon the historic comments of APRA in support of the proposition that policy advocacy could be permissible and not transgress the sole purpose test. In 2006, in a submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Structure and Operation of Superannuation Industry, APRA had said:

> If an individual fund was to advocate on certain policy issues, and the cost of such advocacy was funded with members' monies, the issue of whether or not such an activity was in breach of the sole purpose test would require an assessment of the activity and its connection with the superannuation purposes. If the activity is characterised as an expenditure or investment made in good faith and the trustee puts forth cogent reasons for believing that this will result in an improved retirement income outcome for the members (or the protection of that retirement income), then the trustee's conduct would be unlikely to be in breach of the sole purpose test (even if others might disagree with the trustee's reasoning).

55. Indeed, the AIST submitted:

> Advertising that aims to protect the existing default system, which sees members defaulted into the higher-performing, lower-fee sector, also benefits members.

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[52] *Aid/Watch Incorporated v Commissioner of Taxation* (2010) 241 CLR 539.

[53] "*Provided the advertising is relevant to superannuation and retirement and has the objective of improving outcomes for members then it is warranted, as has been found by APRA. The reality is that superannuation funds operate within a complex and ever changing political and regulatory landscape.*"

[54] "*Political advertising must relate to superannuation to qualify as legitimate fund expenditure. Such advertising is a valid form of advocacy and should continue to be permitted.*"

> This also enables profit-to-member funds to continue to build scale, which is important to continuing high performance and low fees.
>
> Fox and Henhouse is an example of advertising that benefits members. In fact, the Fox and Henhouse campaign highlighted the very issues exposed by the Royal Commission.

56. As it unfolded, Counsel Assisting stopped short of submitting any wrongdoing on the part of AustralianSuper, and Commissioner Hayne did not find otherwise:

> Even if a rule of that kind could be made (and I do not stay to examine how the implied freedom of political communication might apply) it is not a rule that I consider should be made. Rather, I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.

57. Spending on advertising, insofar as it seeks to maintain or increase scale by retaining existing members or attracting new ones or both, may be consistent with the sole purpose test. On the other hand, not every form of political advertising by a superannuation fund constitutes a failure to act in the best interests of members or a use of members' funds other than in satisfaction of the sole purpose test. Nice questions of judgment are indeed required.

Financial Planning & Advisor Fees

58. Many trustees of RSEs have permitted payment out of a member's account of fees certified by either the advice licensee or the authorised representative to be fees for advice about the member's superannuation arrangements.

59. The Royal Commission was concerned that in many cases, the services to be provided by the adviser had been so loosely defined that the advice provided may, but need not, include advice about whether to alter the client's financial plans or arrangements about post-retirement income. Counsel Assisting also tested APRA's Helen Rowell as to whether APRA has considered if a trustee is automatically or regularly debiting money from members' accounts and paying it to advisers who are not providing a service to the members, is that consistent with the sole purpose test? Mrs Rowell confirmed that APRA was aware of ASIC's investigation into the so-called 'fees for no service' issue, but APRA had not yet decided whether to take any action against trustees for breach of the sole purpose test; it did not want to 'intervene in ASIC's process'.

60. Commissioner Hayne concluded that the nature of the advice that may properly be paid for from a superannuation account is limited to advice about particular actual or intended superannuation investments. This may include such matters as consolidation of superannuation accounts, selection of superannuation funds or products, or asset allocations within a fund. It would not include broad advice on how the member might best provide for their retirement or maximise their wealth generally. Any practice by trustees of

allowing fees for these latter kinds of financial advice to be deducted from superannuation accounts must end.

61. He reasoned that this was because using superannuation money to pay for such broad financial advice as not consistent with the sole purpose test prescribed by section 62 of the SIS Act:

> All of the core purposes specified hinge on the provision of benefits upon a member's death or retirement. So understood, it is not consistent with the sole purpose test for a trustee to apply funds held by the trustee in paying fees charged by an adviser to consider, or re-consider, how best the member may order his or her financial affairs generally or may best make provision for post-retirement income.

62. With the promise of greater co-ordination between APRA and ASIC in the post-Hayne era, it seems likely that these regulators will be emboldened by Hayne's analysis and chance their arm in more cases of this kind.

Social Impact Investing

63. Section 62 is self-evidently 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.[55]

64. The SIS Act intentionally avoids overly restrictive regulation of investment practices of superannuation funds. Certain kinds of investments regarded as inconsistent with superannuation policy objectives and specifically restricted or prohibited under provisions of SIS:
    - s 65 lending or providing financial assistance to members;
    - s 66 acquisition by a fund of assets belonging to members or their relatives, with certain exceptions;
    - s 109 all investments by superannuation entity to be on "arm's length" basis;
    - part 8 of SIS rules applying to investment in "in-house assets".

65. Some argue that a key stumbling to impact investing block is the sole purpose test, especially for those in Gen Y, who as their name suggests, question the need for this on every single investment.[56]

66. The problem is said to be acute for impact investing because, taken literally, s 62 exhaustively defines the "core" and "ancillary" purposes. It thereby entrenches the

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[55] *Sutherland v Woods* [2011] NSWSC 13 at [115].

[56] Editorial (David Rowley), "Is the Sole Purpose Test Out of Date?", *Conexus Investment Magazine*, August 2015, p 119.

sovereignty of those purposes over all other matters to which a trustee might have given consideration.[21] In so doing – it is said - it inspires the impression that investments that are made not purely for financial gain, such as impact investments, may be off-limits for superannuation funds.[57]

67. 'Impact investments' are investments made with dual aims – a financial return and either a social or environmental return. A number of major funds have a significant track record in applying an ethical and/or ESG lens to their investment philosophy.

68. Indeed, Good Super[58] has 100 percent of funds in impact investments:[59]

> We allow our members to select the cause that matters most to them from our list of causes. We achieve this by creating growth focused investment options promoting gender equality, LGBT rights, and animal welfare along with other investment options that exclude specific issues such as fossil fuels. These growth-focused investment options are then paired with a defensive portfolio, the combination of which is determined by you.
>
> Our current investment options include: Good Super, Dump Trump, Boycott Weapons, Boycott Adani, Boycott Fossil Fuels and Coal Seam Gas, Animal Welfare, Deforestation, Gender Equality, LGBT Rights, Excessive CEO Pay, and Cash and Fixed Income.

69. But despite these dual aims, properly applied, the 'sole purpose test' does not *prohibit* positive social outcomes. It is not the *type* of investment which must be considered for the purposes of the sole purpose test but rather it is the *purpose(s)* for which the investment is made and maintained that is relevant to the test.

70. Christian Super illustrates this well. Christened in 1984 to provide a superannuation option for Christians by combining financial and biblical principles. The methodology adopted by Christian Super provides an insight into their compliance with the sole purpose test:[60]

> When evaluating an impact investment, one member of the investment team first assesses its financial characteristics. If it does not meet standard return or other investment objectives, due diligence does not progress. If it does, another team member will independently evaluate the social impact case. Only if strong financial and social returns are demonstrated will Christian Super proceed.

71. Based on this methodology, Christian Super invests in corporations that "demonstrate sound ethical practices, signified by honesty, integrity and accountability" and "avoid

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[57] Scott Donald, Jarrod Ormiston and Kylie Charlton, 'The potential for superannuation funds to make investments with a social impact' (2014) 32 *Company and Securities Law Journal* 540, p 543.

[58] See www.goodsuper.com.au

[59] https://www.good.com.au/our-investment-philosophy/

[60] https://www.christiansuper.com.au/files/Christian%20Super.pdf

investing in corporations that engage in addictive or harmful goods or services"[61] The fund also puts substantial emphasis on investments that generate real long-term community impacts. It has allocated around 8% of the fund to investments in clean technology, renewable energy, sustainable agriculture, microfinance, community infrastructure and community finance.

72. Consideration of social and environmental responsibility might in fact be 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.[62] Climate change risks can – and it seems, should - be considered by trustee directors to the extent that those risks may intersect with the financial interests of a beneficiary of a superannuation fund.[63] So far, APRA's remarks have focused on climate as factor to be taken into account in a trustee's risk management strategy[64] rather than as matter overriding strategy for their investment portfolios.[65]

73. With social impact investing, benefits typically flow to a party unrelated to the trust, rather than a benefit flowing to members and their families. A social impact investment which is undertaken as part of a properly considered and formulated strategy, and which complies with the arm's length rule and other SIS investment restrictions, is unlikely to cause the fund to fail the sole purpose test unless exceptional circumstances exist.

74. Nonetheless, the risk of breach of s 62 remains for impact minded trustees, including if, for example:

    - social impact investment and activities of employer sponsor or some other associated person becomes intertwined, or

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[61] See www.christiansuper.com.au ("*As part of our responsible investment strategy we intentionally screen our investments to make sure that Christian Super does not invest in industries such as stem cell research and atomic or chemical weaponry and greatly limits exposure to such industries as gambling and tobacco*.")

[62] See further Parliamentary Joint Committee on Corporations and Financial Services, *Corporation Responsibility: Managing Risk and Creating Value* (2006) [5.16].

[63] Noel Hutley SC and James Mack (Commissioned by Market Forces), "Superannuation Fund Trustee Duties and Climate Change Risk" (Memorandum of Opinion, Environmental Justice Australia, June 2017. Stephanie Venuti and Martijn Wilder, 'Obligations on Australian Companies to Address Climate Change' (2018) 92 *Australian Law Journal* 789.

[64] See Geoff Summerhayes, "Australia's New Horizon: Climate Change Challenges and Prudential Risk" (Speech delivered at the Insurance Council of Australia Annual Forum, Sydney, 17 February 2017 ("[*I*]*f entities' internal risk management processes are not starting to include climate risk as something that has to be considered – even if risks are ultimately judged to be minimal or manageable – that seems a pretty reasonable indicator there might be something wrong with the process. Similarly, if you're an investor and you're not already asking questions about how the companies you invest in approach these issues – perhaps you should be*").

[65] Compare South Pole Group, Submission No 8 to Senate Economics Reference Committee, *Carbon Risk Disclosure*, 30 March 2016, p4.

- there are 'incidental advantages' to members from social impact investment and the trustee cannot demonstrate that provision of retirement benefits for members is the overriding consideration behind the investment decision.

Has the sole purpose test outlived its usefulness?

75. Despite that foreboding, it remains important to consider whether the sole purpose test has actually outlived its usefulness? Plainly, the sole purpose test does restrict a fund's focus, offerings, and actions. The sole purpose test does not allow the provision of a broader range of financial or other services relating to the non-superannuation interests of members of the fund. This has prompted Deloitte's Russel Mason and David Johnson[66] to criticise the utility of the sole purpose test:

> We have lost count of the number of times funds think of great ways to help members achieve their financial goals, but are prevented from doing so for fear of breaching the Sole Purpose Test.

76. For them, the sole purpose test is a "*relic*" of the old corporate superannuation system where there were significant tax incentives to place large amounts of savings into superannuation funds which could not have coped with the administrative burden of a financial offering that extended beyond super.

> We live in a very different world today than that was being experienced by Australians 35 years ago when the need for the Prices and Incomes Accord was agreed and a compulsory contributions scheme was realised. The idea that superannuation stands separate to other financial considerations is no longer valid. With the pressures of the financial obligations that most Australians take on in their working lives, we need a system that better integrates superannuation with the rest of our financial lives.

77. Making this happen might well be as simple as simple as inserting an additional clause to section 62 of the SIS Act, by adding as an additional core purpose in s 62(1)(a) a new:

> (vi) the provision of savings, insurance and investment facilities for each member of the fund

78. Attractive as that might be to some trustees, in my view, it seems difficult to resolve that question without first resolving the anterior debate - that still lingers – what should be the objective of the superannuation and the superannuation system?

79. The Henry Tax Review explained the role of the superannuation system thus:[67]

> The superannuation system is one part of Australia's 'three pillar' retirement income system. The first pillar is the social security Age Pension. Compulsory superannuation contributions made under

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[66] Russell Mason & David Johnson, (Deloitte) "The Sole Purpose Test – relevant or in need of change?" *Super Review*, 10 December 2018.

[67] Australia's Future Tax System Review, *Australia's future tax system: the retirement income system: report on strategic issues*, Commonwealth of Australia, May 2009, p. 8.

> the superannuation guarantee regime is the second pillar. The third pillar is additional private savings, often made through additional voluntary superannuation contributions.

80. The Financial System Inquiry's final report suggested a primary objective for the superannuation system - '*to provide income in retirement to substitute or supplement the age pension'*.[68] The final report also included a number of subsidiary objectives, nominating reasons why the objective was important.

81. As the Shadow Treasurer Chris Bowen acknowledged, an objective:[69]

> … is an idea arresting in its simplicity. Many people would think that we already had one, but we do not. Superannuation means different things to different people, in terms of what it is designed to achieve.

82. Regrettably, debate on the preferred objective still continues, at times oscillating between semantics and ideology.[70] Superannuation assets form an important and growing part of household wealth. The Australian Bureau of Statistics has estimated that superannuation savings account for some 17 per cent of average household assets, with property assets (including the value of occupied housing) accounting for around 56 per cent of household assets.[71] Yet analysis by the Grattan Institute has shown that superannuation assets held by households are largely held by wealthier households, which also tend to hold significant wealth outside of the home and superannuation.[72]

83. The sooner we get this foundation right, the sooner a coherent superannuation system – and attendant regulatory regime - can be constructed upon it.

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[68] *Financial System Inquiry: final report*, (Murray Report), Treasury, Canberra, November 2014, p. 95.

[69] C Bowen, Second reading speech: Superannuation (Objective) Bill 2016, Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016, Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 House of Representatives, *Debates*, 22 November 2016, p. 3875.

[70] For key extracts of particular organisation's positions, see Australian Parliamentary Legislation Digest on the Superannuation (Objectives) Bill 2016.

[71] Australian Bureau of Statistics (ABS), *Household income and wealth, Australia, 2013–14*, *Income, wealth and debt: low economic resource households, household assets and liabilities*, data cube 3, table 3.7, cat. no. 6523.0, ABS, Canberra, 4 September 2015.

[72] J Daley, B Coates and H Parsonage, *How households save for retirement*, Background paper, Grattan Institute, Melbourne, October 2016, p. 5.