

9. Duties of the responsible entity

Introduction

9.1. This chapter identifies the principal fiduciary duties owed by responsible entities to members of superannuation schemes. The Review recommends that they expressly be included in a statute as obligations from which a responsible entity cannot be excused by the governing document of the superannuation scheme.

Legal structure of superannuation schemes

Trust structure

9.2. All of the superannuation schemes established by employers in the private sector are established as trusts. Superannuation schemes covering public servants are established by Acts of Parliament, most of which are run as trusts. In DP 50 the Review noted that, in much of the literature concerning reform of superannuation, it was assumed that the trust is the most appropriate structure for superannuation schemes. The Review raised the issue whether some other structure would constitute a more appropriate legal form for superannuation.¹ Very few submissions addressed this issue and those that did considered that the trust was the most appropriate legal structure for superannuation schemes.²

The 'traditional' trust

9.3. *The history of the trust concept.* The trust as a legal concept has existed for approximately 1000 years. Before the Norman Conquest of England, individuals could transfer land to others and take a promise from the transferee that the latter would hold the land 'to the use of' those persons whom the transferor described. The concept of the 'use' which emerged from this practice became an important means of transferring land upon death without having to pay feudal taxes.³ The Statute of Uses was enacted in 1535 to restrict this form of land holding (and tax avoidance). The effect of the Statute could be avoided by the

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1. DP 50 para 2.18. For a discussion of the issue whether trusts law does or can provide a suitable framework for the regulation of pension schemes, see Moffat & Chesterman, *Trusts Law: Text and Materials* 533–55.
 2. National Mutual *Submission* February 1992; Perpetual Trustees *Submission* March 1992; ASC *Submission* March 1992. G Walker, however, suggested that the general principle of trust law may well be redundant: *Submission* February 1992.
 3. Ontario Law Reform Commission *Report on the Law of Trusts*, vol 1 p 5.

creation of two successive uses. The 'use upon a use' was finally recognised by the Court of Chancery in the early seventeenth century. To distinguish the second use from the first, it was called a trust, and the 'modern' law of trusts began to develop.

9.4. The key features of a traditional trust. A principal feature of a trust is the vesting of title to property in a person or persons on behalf of, or for the benefit of, another person or persons, or for the advancement of certain purposes. The holder of the legal title to the property is the trustee. The other party (or parties) is (are) the beneficiary (or beneficiaries). The person who provided the trust property is called the settlor. The settlor may be the trustee, the beneficiary or some third party. The key elements present in every such 'traditional' trust are

- **The trustee.** The trustee may be a person, several persons or a body corporate. The trustee owes a fiduciary duty to the beneficiary. It is a duty imposed upon the trustee not to place his or her personal interest in conflict with the interests of the beneficiary and not to use the position of trustee to acquire an advantage, whether or not at the expense of the beneficiary. A fiduciary must act honestly in what he or she considers to be the best interest of the beneficiaries.
- **The trust property.** The property may be real or personal. The trustee must have title to the property, not just possession, and this will be the legal title unless the property itself is solely equitable in nature.
- **The beneficiary.** The trustee may be a beneficiary but the trustee cannot be the sole beneficiary. The extent of the beneficiary's interest in the property is determined by the deed or other instrument constituting the trust, or by operation of law.
- **A personal obligation to deal with the trust property.** The trustee is under a personal obligation to deal with the trust property for the benefit of the beneficiary and this equitable obligation is annexed to the trust property.⁴

9.5. The trust concept in collective investments. Trusts were able to overcome the problem that unincorporated groups could not own property. The trustees hold property for the group, on the terms established by the trust deed.

4. Meagher & Gummow, *Jacobs' Law of Trusts in Australia* 8-9.

The trust was used as the basis for life insurance companies in which the members and the trustees entered into mutual covenants. It was also used as the basis for collective investment schemes and collective savings schemes.⁵ Superannuation is a collective investment scheme which generally uses the trust form.⁶

9.6. *The trust concept in superannuation.* The trust is used in superannuation schemes to enable a wide range of interests in property to be created for beneficiaries. Nearly all superannuation schemes to which OSSA applies are trusts. Superannuation trusts are often established by complex deeds that set out the powers, duties and responsibilities of trustees and the interests of the beneficiaries. This gives considerable flexibility to cover a wide range of public and private schemes, though increasingly, the terms of the deed are influenced by tax considerations.⁷ Superannuation schemes sometimes employ professional trustees, such as trust companies, that operate under State and Territory legislation. A higher standard of care is expected of professional trustees.⁸

Distinctive features of employer related superannuation trusts

9.7. While private employer related superannuation schemes are structured as trusts they have some distinct features, which differ from traditional trusts.⁹ Some of these have been introduced by government policy, backed up by tax concessions.

- *Beneficiaries are not always volunteers.*¹⁰ A number of employer related schemes involve employee contributions, or an election by the employee to convert some of his or her salary into an employer contribution, to a superannuation scheme.

5. Moffat & Chesterman *Trusts Law: Text and Materials*, 525–6, quoting *Cooke Corporation, Trust and Company* 86–7.

6. There are exceptions such as superannuation schemes consisting entirely of policies of life insurance.

7. To get the tax concession available to superannuation schemes, OSSA requires deeds must contain certain clauses.

8. See para 5.2.

9. These features were recently examined in some detail in a speech by Lord Browne-Wilkinson, a Lord of Appeal in Ordinary, *Equity and its Relevance to Superannuation Today*, paper presented at the Superannuation 1992 Conference, Canberra, February 1992.

10. That is, recipients of a gift.

- *Associated contract of employment.* This special factor is closely allied to the first as being in paid employment is a legal condition of membership of a superannuation scheme.¹¹ Membership of an employer related scheme is also conditional upon employment with a particular employer.
- *Employer's obligation to fund.* The introduction of the SGL legislation will mean that all employers will be compelled to provide superannuation for their employees. Unlike a settlor, the employer cannot choose the recipients of this particular kind of 'bounty'.
- *Employer's continuing financial interest.* In employer related schemes, employers obviously have an interest in any scheme they are required to finance. Under the SGL legislation all employers will be compelled to contribute a growing proportion of their wages bill to a complying superannuation scheme. In the case of defined benefit schemes, employers have an added interest in the fate of the scheme as they, not the employees, bear the investment risk. Employers also often have a residual interest in the surplus, if any, of the scheme upon its termination.
- *Beneficiaries are entitled to representation on trustee body.* Unlike traditional trusts where beneficiaries do not have any right to appoint trustees, the OSS Regulations will soon require all schemes with 200 or more members to have at least 50% of the trustees as representatives of the members.¹² Often the member representatives will also be beneficiaries.
- *Variable size of the trust fund.* In a traditional trust the size of the trust fund is normally defined at the outset and added to in readily identifiable portions. This is not the case with collective investments or superannuation schemes. The size of the trust fund is continually fluctuating due to payments in and out. In defined benefit schemes in particular, the size of the scheme will depend heavily on actuarial calculations.

11. Although members who temporarily leave the workforce may remain a member of a scheme for up to two years: OSS Regulations reg 5AA.

12. OSS Regulations reg 13. Currently, the only funds that are required to have equal representation are those with 200 or more members, established after a prescribed date (16 December 1985 for private sector funds, 25 May 1988 for public sector funds). This requirement will apply to all funds with 200 or more members from 1 July 1995. The Review recommends that this requirement extend to all schemes with 50 or more members: see recommendation 12.4.

- *The employer's power to veto amendments to the terms of the trust.* Frequently the employer has a power of veto over any proposed change to the terms of a superannuation trust deed. The settlor on the other hand, does not normally reserve such a power.

Consequences of the special features of superannuation trusts

9.8. In traditional trusts the central concept is that the settlor acts out of bounty, and that the beneficiaries are fortunate recipients who have given no consideration. Clearly, this concept has limited relevance to superannuation schemes, especially where the employer is obliged by law to contribute and the employee can also contribute. Consequently, the doctrine of the resulting trust under which any surplus funds will revert to the employer as settlor must be questioned if the employer is not in fact the settlor.¹³ Similarly, the right claimed by the employer in many schemes to determine the original content and to control the amendment of the rules must derive from some source other than the employer's role as settlor. Clearly it could not be said to arise from the traditional source of the settlor's right to reserve powers to him or herself. It has been suggested to the Review that such a power could possibly be construed as a contractual provision based on the employment relationship.¹⁴

Duties of a trustee

Principle duties

9.9. While superannuation schemes have features that distinguish them from traditional trusts, it does not necessarily follow that trust law applies differently to the superannuation trustee or that the duties and responsibilities of trustees are inappropriate for trustees of superannuation schemes. The duties of trustees have been developed, along with the concept of the trust, over many years and their fiduciary nature is highly appropriate to the needs of superannuation schemes.

A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of honour the most sensitive, is then the standard of behaviour. As to this there has developed a tradition that is unbend-

13. Lord Browne-Wilkinson described it as a doctrine of 'dubious application' to superannuation schemes: *Equity and its Relevance to Superannuation Today*, 6.

14. Lord Browne-Wilkinson *Equity and its Relevance to Superannuation Today* 6; see also Austin 'The Role and Responsibility of Trustees in Pension Plan Trusts: Some Problems of Trust Law' in Youdan (Ed) *Equity Fiduciaries and Trust* 113 where he notes that superannuation schemes, from a commercial point of view, 'frequently have the flavour of a bargain struck between the employer and representatives of employees'.

ing and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rules of undivided loyalty by the disintegrating erosion of particular exceptions. Only thus has the level of conduct of fiduciaries been kept at a level higher than that trodden by the crowd.¹⁵

This fiduciary duty of a trustee has been said to comprise four fundamental duties

- the duty not to act for his or her own benefit or for the benefit of a third person
- the duty to treat beneficiaries of the same class equally
- the duty to treat beneficiaries of different classes fairly and
- the duty not to act capriciously or totally unreasonably.¹⁶

In DP 50 the Review suggested that, in addition to the duties outlined above, the trustee also owed a duty to act personally, honestly and to avoid conflict of interest and to exercise diligence and care in carrying out its functions under trust deed. Other important duties of trustees include:

- the duty to preserve the trust property
- the duty of loyalty (to the terms of the trust)
- the duty to keep and to render the beneficiaries full and candid accounts
- the duty to act personally.¹⁷

Trustees also have a duty to administer the trust fairly and effectively. This involves establishing procedures for

- processing membership applications
- recording personal membership details and benefits
- prompt receipt, banking, recording and accounting for all income including contributions, investments and insurance profits
- effective follow up of any contributions arrears
- receipt, approval, payment and recording of all expenditure including benefit payments, insurance premiums, administration expenses, investment and other professional fees, trustee expenses, statutory and legal costs
- regular auditing of accounts and control systems

15. *Meinhard v Salmon* (1928) 164 NE 545 Cardozo J, cited in Ford & Lee *Principles of the Law of Trusts* 2nd ed, 391.

16. Finn *Fiduciary Obligations* 45–6.

17. Ford & Lee *Principles of the Law of Trusts* 393.

- regular reporting to the trustee on the overall management of the fund with particular attention to investment performance, financial results and general trend analysis requiring policy review
- regular reporting to members on personal entitlements and the overall management and performance of the fund.¹⁸

The Review accepts that these duties are illustrative only, not exhaustive. They do, however, adequately demonstrate the kind of duties imposed on trustees sufficiently to enable a judgment to be made that they are duties appropriate to apply to the responsible entities of superannuation schemes.

Trust deed can not derogate from duties

9.10. Trustees cannot depart from or act inconsistently with these fiduciary duties unless especially permitted to do so by the trust deed. The Review considers it to be of great importance that the deed not permit derogation from the proper duties of trustees and that those duties ought to be clearly identified. This is especially important for those trustees who are unfamiliar with their duties. All employees will in future be required to be members of a superannuation scheme. As such, they require the full protection of the fiduciary duties imposed by equity upon superannuation scheme trustees. The presence in deeds of clauses that permit acts which would otherwise be prohibited by the general rules of equity are, however, commonplace.

Proposal to clarify minimum duties

Proposal

9.11. The Review is firmly of the view that it is inappropriate for the trust deed to contain clauses that allow a significant reduction of the duties imposed upon the responsible entity. It proposed in DP 50 that a minimum set of fiduciary responsibilities of the responsible entity be clearly identified and, where appropriate, included in legislation applying to superannuation schemes with a requirement that the deeds or other instruments constituting a superannuation scheme would not be able to derogate from these obligations.¹⁹ This was supported by submissions.²⁰

18. MTIA *Submission* February 1992.

19. DP 50 para 5.25, proposal 5.16.

20. See details at para 9.16.

Codification of superannuation scheme trustee duties — overseas experience

9.12. *United States.* The United States *Employee Retirement Income Security Act 1974* (ERISA) requires every employee benefit plan established under the Act to name one or more fiduciaries in the written instrument establishing the plan.²¹ In the discharge of their duties in respect of the plan, fiduciaries are expected to exercise

the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man, acting with the like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims.²²

They are also required to diversify the investments of the plan so as to minimise the risk of loss unless under the circumstances it is clearly prudent not to do so.²³ A fiduciary is also prohibited from

- dealing with the assets of the plan 'in his own interest or for his own account'²⁴
- acting in any capacity in a transaction involving the plan on behalf of a party whose interests are adverse to those of the plan or its beneficiaries²⁵
- receiving any consideration from any party in connection with a transaction involving the plan.²⁶

9.13. *Canada.* Codification of duties is also the approach taken in some provinces of Canada. For example, the *Pension Benefits Act 1987* (Ont) sets out the essential duties of administrators of pension plans. Under the Act the administrator is given overall responsibility for the general administration and investment of the pension plan and its funds.²⁷ The Act also includes several provisions entrenching key fiduciary duties of plan administrators. Section 23 of the Act specifically imposes a duty on the administrator to

21. ERISA s 402(a)(1).

22. ERISA s 404(a)(1)(B).

23. ERISA s 404(a)(1)(C).

24. ERISA s 406(b)(1).

25. ERISA s 406(b)(2).

26. ERISA s 406(b)(3).

27. The full range of administrative and fiduciary obligations of pension plan administrators is discussed in Dickson QC 'The Administration of Pension Plans and the Administrator's Agents; Their Duties and Responsibilities' (1988) 9 *Estates and Trusts Journal* 39.

exercise the care diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.²⁸

That section also imposes on the plan administrator a standard of care which relates to the knowledge available to the administrator or which he or she ought to possess, rather than an absolute standard of care. The administrator of a pension plan is required to use, in the administration and investment of the pension fund, all relevant knowledge and skill that the administrator possesses, or, by reason of his or her profession, business or calling, ought to possess.²⁹

Codification in Australia

9.14. *Model trustee code.* Codification of the duties of trustees generally has been considered in Australia for some time, most frequently in relation to authorised trustee investments. This matter is currently the subject of a review by a sub-committee of the Special Premiers' Conference Working Party on Non Bank Financial Institutions. A wide ranging review of the standards that may be expected of trustees was produced by a private group of experts in 1989.³⁰ The group suggested that legislation covering trustees should clearly establish that, unless permitted by law or expressly authorised by the trust instrument, the fiduciary duties of a trustee include that the trustee shall not

- make any profit or derive any benefit from his or her connection with the trust, whether for the trustee or for any other person
- allow his or her own personal interest to conflict with his or her duty as trustee
- undertake any duty which conflicts with his or her duty as a trustee.³¹

The group also proposed that

[i]n the management and administration of the trust including the exercise of its powers, authorities and discretions, the trustee shall act with care, skill, prudence and diligence having regard to —

28. *Pension Benefits Act 1987 (Ont)* s 23(1).

29. *Pension Benefits Act 1987 (Ont)* s 23(2).

30. The group consisted of Mr Justice Meagher, NSW Supreme Court; Mr Justice Gummow, Federal Court of Australia; Professor Emeritus HAJ Ford, University of Melbourne; Dr IJ Hardingham, Victorian Bar; Professor PD Finn, Research School of Social Sciences, Australian National University; Mr N Crago, Senior Lecturer in Law, University of Western Australia; Mr BT Ball, former General Manager Queensland Trustees Limited and Mr WA Lee (Convenor and Secretary).

31. Model Trustee Code for Australian States and Territories, section 1.10, cited in WA Lee 'Current Issues for Trustee Legislation' (1990) *University of Western Australia Law Review* 507-537, 514.

- (a) the nature, composition and purposes of the trust; and
- (b) the skills which the trustee possesses or ought, by reason of his business, or calling, to possess.³²

In relation to the important question of the investment of funds, the group proposed, that

- [i]n the exercise of its powers of investment the trustee shall consider
- (a) the trust fund as a whole, the nature, composition and purposes of the trust and its anticipated duration
 - (b) the needs and circumstances of the beneficiaries
 - (c) the suitability of the investments held and of investments proposed
 - (d) the need for diversification of investments
 - (e) the administrative costs, including commission, fees, charges and duties payable, of making or varying any investment;
 - (f) the taxation consequences of making or varying any investment, and
 - (g) the possible impact of inflation or deflation.

9.15. *Codification of trustee duties and the Corporations Law.* The Corporations Law imposes upon trustees of prescribed interest schemes a number of duties which cannot be modified. These duties are imposed by means of statutory covenants. They include that the trustee will

- cause the accounts to be audited³³
- take the reasonable steps necessary to become informed of the exercise by the management company of its powers and the performance of its functions, under the deed³⁴
- retire from office in the prescribed circumstances³⁵
- exercise all due diligence and vigilance in carrying out its functions and duties and in protecting the rights and interests of the holders of the prescribed interests³⁶
- perform its functions and exercise its powers under the deed in the best interests of all the holders of the prescribed interests and not in the interests of the management company or the trustee if those interests are not the same as those of the holders of the prescribed interests generally³⁷
- subject to the immediately preceding point, treat the holders of prescribed interests of the same class equally and will treat the holders of prescribed interests of different classes fairly.³⁸

32. Model Trustee Code s 1.11.

33. Corporations Regulations reg 7.12.15(5).

34. Corporations Regulations reg 7.12.15(2)(g).

35. Corporations Regulations reg 7.12.15(2)(e).

36. Corporations Law s1069(1)(e)(i).

37. Corporations Regulations reg 7.12.15(1)(f)(i).

38. Corporations Regulations reg 7.12.15(1)(f)(ii).

Submissions and conclusions on the Review's proposals

9.16. *Submissions.* While most submissions supported the Review's proposal, some opposed it in the belief that it would involve codification of all the fiduciary duties of responsible entities and of the members of the boards of responsible entities.³⁹ The Review did not intend to codify or alter the underlying equitable principles. The proposal was limited to the inclusion in legislation of a minimum set of duties that could not be derogated from by the deed or other constituting document. That aspect of the proposal received widespread support from industry groups,⁴⁰ superannuation scheme providers,⁴¹ the ACTU,⁴² the Australian Securities Commission⁴³ and individuals.⁴⁴ The favourable reaction to this proposal and the Review's consultations⁴⁵ have confirmed its view that the inclusion of a minimum set of duties in legislation will bring the advantages mentioned in DP 50, namely

- it will lead to a better understanding and awareness of responsible entities' legal responsibilities and those of members of boards of responsible entities
- it will enable uniform modification of common law trust principles which are not appropriate for superannuation schemes
- it will enhance the ability of the regulator to enforce the fiduciary obligations of responsible entities when necessary
- it will eliminate the possibility that obligations considered essential for responsible entities of superannuation schemes could be eroded by the terms of the trust deed or other constituting document.⁴⁶

9.17. *Recommendation.* Accordingly, the Review recommends that the law should include a set of fiduciary obligations for responsible entities of superannuation schemes, ADFs or PSTs. The duties should be paramount. To the extent that they conflict with other provisions of the governing document, the other provisions should be void.

39. JSW Higgins, Partner, Mallesons Stephen Jacques *Submission* February 1992; Mercer Campbell, Cook and Knight *Submission* February 1992; Commonwealth Bank Group Financial Services *Submission* February 1992.

40. IFA *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; ASFA *Submission* March 1992; LIFA *Submission* March 1992.

41. AMP Society *Submission* February 1992; National Mutual *Submission* February 1992.

42. *Submission* February 1992.

43. *Submission* March 1992.

44. P Burke *Submission* February 1992, J Aitken *Submission* February 1992.

45. In particular those with Lord Browne-Wilkinson.

46. DP 50 para 5.25.

Recommendation 9.1: Fiduciary obligations of responsible entities to be set out in legislation

The law should set out the basic fiduciary obligations owed by responsible entities of superannuation funds, ADFs and PSTs to members. This provision should not affect any other duty that may be imposed on the responsible entity by the deed or other instrument constituting the fund, ADF or PST, or by some other law, if the other duty is not inconsistent with the basic obligations set out. Any provision of a deed or other agreement that purports to modify or exclude these basic obligations should be of no effect.

The essential duties of responsible entities

Duty to hold property for benefit of members

9.18. The responsible entity, by the very nature of being in a position of trust, does not hold the assets of the scheme in its own right. Rather it holds them on trust for, or for the benefit of, the members of the scheme. It should hold the property of the scheme not for the use or benefit of itself, but for the use and benefit of the members.

Duty to become familiar with the deed and interpret the deed or other rules fairly

9.19. The duty on trustees to act fairly when dealing with beneficiaries whose rights are dissimilar is well established. The Review acknowledges that it will be important to spell out to responsible entities that this duty is a duty to act honestly in the interest of all the beneficiaries of the scheme, and that such actions can, on occasion, result in apparent unfairness from the point of view of an individual beneficiary. This situation has been acknowledged by the courts:

[it] is obvious that a decision which is considered to be fair for the ultimate benefit of the estate may be for the immediate advantage of one beneficiary, and to the disadvantage of the other.⁴⁷

Duty to act honestly

9.20. It may be argued that a responsible entity cannot be acting in a position of trust if it does not act honestly. This obligation is, nevertheless, of such fundamental importance that it should be included in legislation,

47. *In re Charteris; Charteris v Biddulph* [1917] 2 Ch 379 379; see also *Perpetual Trustee Co v Noyes* (1925) 25 SR (NSW) 226, 248-9.

Duty to avoid conflict of interest and to fully disclose such conflicts

9.21. The importance of this duty in relation to trusts generally has already been referred to. The duty is of fundamental importance in the case of superannuation schemes, where the employer's representatives on the board of the responsible entity may be faced with a conflict of interest in considering proposals by the employer sponsor for investment by the superannuation scheme in the employer's enterprise. Accordingly, it should be specifically included as a requirement of responsible entities under the law. The fact that the Review proposes that such investments be permissible⁴⁸ does not relieve the responsible entity or members of the responsible entity board from this obligation. The employer representatives on the board of a responsible entity of a defined benefit scheme face an additional source of potential conflict when the actuary recommends a change in the assumptions governing the employer contribution which provides the employer with an opportunity to reduce its contributions.

Duty to act always in the best interests of the members of the scheme

9.22. Ford & Lee describe this duty as the duty which 'marshalls' the trustee's duty of loyalty to the service of the economic wellbeing of the trust fund and of the personal welfare of the beneficiaries.⁴⁹ This is a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill.

Duty to exercise care, diligence and skill

9.23. This duty should encompass the administration and investment of the superannuation scheme's funds. The level of skill to be exercised by a trustee has been held to be that which a person of ordinary prudence would exercise in dealing with the property of another person for whom he or she felt morally bound to provide.⁵⁰ This is not only a high standard, it is an objective standard. Acting honestly, while a fundamental requirement, is not sufficient. It is appropriate to repeat the standard of care, diligence and skill in the law to ensure it is brought to the attention of trustees. A responsible entity who is an individual should also be required to use all the skill and knowledge that he or she possess-

48. Up to 5% of the value of the fund at cost: see recommendation 11.4.

49. Ford & Lee *Principles of the Law of Trusts* 400.

50. *Re Whiteley; Whiteley v Learoyd* (1886) 33 ChD 347

es or, because of his or her profession, business or calling, ought to possess⁵¹ to discharge the important functions of responsible entity. This is not to say that a responsible entity will be held strictly liable for all the misfortunes of the superannuation scheme.

a trustee who is honest and reasonably competent is not to be held responsible for a mere error of judgement . . . provided he acts with reasonable care, prudence and circumspection.⁵²

Duty to keep trust money separate from the employer's assets

9.24. It is now becoming clear that, without the ability of the Maxwell group to control the assets of the pension fund, the massive fraud which appears to have been perpetrated could not have happened. As a consequence of the investigation into the operation of pension funds, the House of Commons Social Security Committee has recommended that independent custodian trustees be appointed to hold all pension fund assets and that all assets of pension funds should have their ownership clearly designated upon them.⁵³ The Review accepts that, as a consequence of the requirement in the definition of a superannuation fund in OSSA that such a fund be established for the 'sole purpose' of providing superannuation benefits,⁵⁴ the assets of single employer sponsored superannuation schemes are likely to be kept in a separate account apart from the employer's assets. To the extent that, in practice, they are not, the law should require them to be separated.

Duty to exercise discretion only after proper consideration

9.25. The ability of the responsible entity to exercise discretion is a feature of virtually every superannuation scheme. The courts will not interfere in the manner in which trustees exercise their discretions provided the trustees can be seen to be acting in good faith. It is clear that this means that a trustee, in deciding whether or not to exercise its discretion, has a duty to consider the possibility of exercising a discretion. Trustees cannot ignore a power and

refuse to consider whether it ought, in their judgment, to be exercised.⁵⁵

51. See *Pension Benefits Act 1987 (Ont)* s 23(2) discussed at para 9.13.

52. *Re Chapman* [1986] 2 Ch 763, 778.

53. House of Commons Social Security Committee Second Report, *The Operation of Pension Funds, 1992* (not yet printed) para 286(vi).

54. OSSA s 3(1).

55. *In re Gulbenkian's Settlement; Wishaw v Stephens* [1970] AC 508, 518 (Reid LJ).

It is argued that, not only has a trustee the duty to consider the exercise of its discretions, but it has a further duty to consider properly the exercise of such discretion. For example, in relation to a pension fund, Lord Wilberforce noted that a trustee's discretion

cannot be controlled by the court unless he exercised it capriciously, or outside the field permitted by the trust.⁵⁶

Similarly, in assessing the exercise by a liquidator in his exercise of a discretion conferred on him, Simonds J held that exercise of a discretion was justified where an opinion has been found *bona fide* and reasonable.⁵⁷ The duty to exercise a discretion only after proper consideration also seems to preclude a trustee from unfairly discriminating against one or more beneficiaries.

Duty to act on advice

9.26. It follows that, if a responsible entity is unable to meet the high objective standard of care required of it, from its own resources, including (in the case of a corporate responsible entity) the resources of the members of its board of directors, it must seek appropriate advice.⁵⁸ The fact that responsible entities of superannuation schemes will frequently comprise employees and employers who have little knowledge of financial markets is not relevant.⁵⁹ The task they are charged with is the proper investment of the superannuation schemes' funds. This must be undertaken with at least some degree of professional skill in an increasingly sophisticated market if the Commonwealth's retirement income policy aims are to be achieved. Accordingly, the requirement to seek proper advice should be imposed on responsible entities by legislation.

56. *McPhail v Doulton* [1971] AC 424 at p 449; see Hardingham 'Controlling Discretionary Trustees' (1975) 12 *University of Western Australia Law Review* 91, 112 ff.

57. *Re Great Eastern Electric Company Limited* [1941] Ch 241; See also *Train v Clapperton* [1908] AC 342 regarding the 'sound and reasonable' exercise of a discretion by a trustee.

58. R Ellinson 'The Golden Fleece? Ethical Investment and Fiduciary Law' (1991) *Trust Law International* 160.

59. In *Fouche v Superannuation Fund Board* (1952) 88 CLR 609, the High Court, describing the standard of care to be observed by the trustee as that of reasonably prudent men of business, said 'It is nothing to the point that they were not men of business at all': 641 (Dixon, McTiernan & Fullagar JJ).

Duty to act personally and not to delegate

9.27. Although it has been commented that

the trustees role has shifted from that of ever-watchful managers of capital to ever-watchful supervisors of managers⁶⁰

it is fundamental to the concept of a superannuation trust that a responsible entity should not be able to shed itself of its responsibilities. This obligation should be included in the law to assist all responsible entities and the members of boards of responsible entities to understand that they will always retain the ultimate responsibility for acts done in their name. It should help make clear that their appointment of an agent, such as a fund manager, does not relieve them of their responsibility in relation to the investment of those funds by the manager.⁶¹

Duty not to profit from the trust

9.28. This duty is often closely associated with the duty to avoid conflicts of interest. It includes a duty not to take advantage of profits even though they could not have been available to the trust and a duty on the responsible entity that it has not by its action prejudiced or disadvantaged the trust in any way. This duty should not prevent an individual who is the responsible entity or a member of the board of management of a responsible entity from receiving reasonable remuneration for work done in that capacity.

Duty to monitor the cash flow of the scheme

9.29. In DP 50 the Review noted the essential obligation of the responsible entity to monitor the cash flow of a superannuation scheme to ensure that the expected liabilities of the scheme could be met as they fell due, and suggested it could fall into the category of duties which should be codified.⁶² The proposal received widespread support.⁶³ As expected, several submissions suggested that it was something that trustees already do or ought to do.⁶⁴ Other submissions, while supporting the concept, were concerned that it not be a complicated

60. Moffatt & Chesterman, *Trust Law: Text & Materials* 550.

61. This is not to say, however, that the responsible entity may not rely on the purported expertise of a fund manager that has been engaged.

62. DP 50 para 7.19, fn 29.

63. IFA *Submission* February 1992; ACTU *Submission* February 1992; Securities Institute of Australia *Submission* February 1992.

64. Permanent Trustee Company Ltd *Submission* January 1992; National Mutual *Submission* February 1992; Mercer Campbell Cook and Knight, *Submission* February 1991.

or bureaucratic exercise.⁶⁵ The Review accepts the point that many responsible entities already perform this function, but considers that all responsible entities should do it.⁶⁶ Thus, the duty to do it should be expressly stated in the law. The ability of the superannuation scheme to meet its expected obligations without having to resort frequently to unplanned borrowing or forced sales of assets is crucial if the responsible entity is to maximise the rate of return within a prudentially sound investment strategy. The Review agrees that the reporting of the responsible entity's compliance with this requirement need not be extensive. Breaches would be breaches of the legislated standards and should be commented on by the auditor.

Duty to take a portfolio approach to investment

9.30. The principal function of a superannuation scheme is the investment of contributions to provide retirement income. Other trusts may or may not have such a long term objective. Because of the importance of the investment function, superannuation schemes are often granted wide powers of investment by their deed or other constituting document, to enable them to establish and manage a broad portfolio of investments. Several authors have observed that the court's approach when reviewing the investment decisions of superannuation schemes has been much more restrictive.⁶⁷ A more appropriate approach is that taken in *Nestle v National Westminster Bank Plc* where it was observed that the standard of care to be observed by trustees set out by *In Re Whitely*⁶⁸ is

capable of adaption to current economic conditions and contemporary understanding of markets and investments . . . Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.⁶⁹

This is not to say that losses on investments made in breach of trust should now be able to be set off against gains in respect of the portfolio, only that an investment which in isolation appears to be risky and therefore may be in breach of

65. AMP Society *Submission* February 1992, Department of Finance *Submission* February 1992.

66. This task, like that of fund management, should be capable of being delegated. The responsibility for ensuring it is done should, however, remain with the responsible entity.

67. Finn & Zeigler 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' (1987) 61 *Australian Law Journal* 329; Gordon 'The Puzzling Persistence of the Constrained Prudent Man Rule' (1987) 62 *New York University Law Review* 52.

68. The level of skill to be exercised by a trustee is that which a person of ordinary prudence would exercise in dealing with the property of another person for whom he be felt morally bound to provide: *In re Whitely* (1886) 33 ChD 247.

69. (1988) Unreported High Court Chancery Division No 1987 of 1988.

trust may be justified when considered in conjunction with other investments.⁷⁰ The Review endorses this approach and recommends that responsible entities be required by the new law to take such an approach in their management of a superannuation scheme's investments. The inclusion of such a duty in the new law would also clarify the approach to be taken when disputing in court a responsible entity's investment decisions. This issue is considered in more detail in chapter 11.

Duty to permit access to trust documents

9.31. The trustee's obligations also extend to allowing beneficiaries to inspect any trust document except for documents relating to the exercise of the trustee's discretion. Without this exemption, trustees would not be able to exercise their discretions impartially and without interference or inhibition.⁷¹ The right of members of large superannuation schemes to access a wide variety of documents from their superannuation schemes could, if heavily used, impose significant costs on the schemes. The OSS Regulations already require superannuation schemes to make information available to members.⁷² The Treasurer has set out extensive new disclosure requirements for superannuation schemes with five or more members.⁷³ These are reviewed in chapter 10. In DP 50, the Review proposed that members of superannuation schemes should have access to information about their interest in the scheme (at no charge) or about the scheme in general (subject to a reasonable access charge).⁷⁴ Submissions strongly supported this proposal.⁷⁵ The only opposition was on the basis that by allowing access to information, it may lead to abuse.⁷⁶ As the members already appear to have the right to request this information, the concern would seem to be unjustified.⁷⁷ The Review agrees that members should have rights of access to documents of their superannuation scheme, subject to considerations such as cost, commercial confidence and privacy rights of other members or confidential commercial information. The Review therefore recommends that superannua-

70. *Nestle v National Westminster Bank Plc* (188) Unreported High Court Chancery Division No 1987 of 1988.

71. *Re Londonderry's Settlement* [1964] 3 All ER 855; *Re Fairbairn* [1967] VR 633.

72. Superannuation schemes must provide the actuary's report, auditor's report and copies of certain notices issued by the ISC on request. This information is available only once a year, however, unless the trustees agree otherwise.

73. Treasurer's statement, paper 2. This includes details of annual report continuous disclosure and access to the scheme's governing rules.

74. DP 50 proposal 6.18.

75. *Westpac Financial Services Submission* February 1992, *LIFA Submission* March 1992, *Australian Shareholders' Association Submission* February 1992.

76. *Jacques Martin Industry Submission* February 1992, *National Mutual Submission* February 1992.

77. The Review accepts, however, that by drawing attention to the fact that members have the right to request information, some additional requests may be generated.

tion schemes should be able to levy a reasonable access charge and copying fee for information requested additional to the information to be supplied free to members under the Treasurer's proposals and the Review's recommendations elsewhere in this report.

Recommendation 9.2: Basic fiduciary obligations of the responsible entity

1. The law should specify the following obligations as basic fiduciary obligations of a responsible entity that cannot be excluded or modified:

- to hold the property of the fund not for the use or benefit of itself or the members of the responsible entity, but for the use and benefit of the members of the fund, including non-contributing members
- to become familiar with and to observe the provisions of the deed or other instrument constituting the superannuation fund or ADF and to apply them fairly as between the members of the scheme
- to act honestly in all matters concerning the fund or ADF
- to avoid any conflict between the interests of the members and the interests of the responsible entity and, if such a conflict arises, to disclose it to the members
- to exercise its powers, and perform its duties, as responsible entity in the best interests of the members
- to act, in relation to all matters affecting the fund or ADF with the care, skill and diligence with which a person of ordinary prudence would act when dealing with property of another for whom he or she was morally bound to provide
- to keep the money and other assets of the fund or ADF separate from the money and other assets of itself, of the members of its board of management and, in the case of an employer sponsored or industry superannuation fund, of any employer involved in the fund
- to exercise a discretion or a power vested in the responsible entity, either by law or by the deed or other instrument constituting the scheme, only after proper consideration
- if it invests the money, or deals with the other assets, of the fund or ADF — to seek advice from an appropriately qualified person before doing so; however, nothing prevents that person from being a member of the board of management of the responsible entity
- not to delegate trustee responsibility in relation to a matter affecting the fund or ADF

- not to profit from acting as responsible entity; this duty should not prevent an individual who is the responsible entity or a member of the board of management of a responsible entity from receiving reasonable remuneration for work done in that capacity
 - to monitor regularly the relationship between the realisable assets of the fund or ADF and its liabilities and prospective liabilities to members to ensure that the scheme is able to pay benefits to which members become entitled as they fall due
 - in determining whether to make a particular investment, to have regard to the whole of the circumstances of the fund or ADF including, but not limited to, the following:
 - its other investments
 - its obligations, both existing and prospective
 - the nature of its membership
 - the desirability of diversifying investments to minimise risk
 - to allow a member access to any information or document in the possession or under the control of the responsible entity that relates to the fund or ADF, except a document the disclosure of which to the member who seeks it
 - would unreasonably disclose another person's private affairs or
 - would disclose trade secrets or other information that has a commercial value that would be destroyed or lessened by the disclosure, and in relation to which the responsible entity is under a duty of confidence to another person not to disclose.
2. Parallel obligations should be imposed on responsible entities of PSTs.

Duty of directors of incorporated responsible entities

9.32. The incorporation of responsible entities is recommended by the Review as one means of ensuring the Commonwealth's constitutional power to legislate for prudential supervision of superannuation schemes. One consequence of incorporation is to make the trustees of a scheme directors of a company that is a trustee. Directors traditionally owe their duty to the company as a separate legal entity. There is authority for the proposition that if a corporation acts as a trustee, the directors of that corporation no longer stand in a fiduciary relation-

ship to the beneficiaries of the trust as the company occupies that role. The director's only liability in this case is said to be as a company director to the company.⁷⁸ However, in a strong dissent Fletcher Moulton LJ noted

[W]here the directors actually perform their part in the management of the company they are both the brains and hands of the company; and they cannot shelter themselves under the plea that the knowledge of the trustee is not their knowledge, or that the nature and intention of the acts of the trustee were unknown to them.⁷⁹

More recently, it has been stated by the Chief Justice of the Supreme Court of South Australia that

[T]here is no authority which establishes that a director of a trustee company is under a fiduciary duty to the beneficiary of the trust in respect of property held by the trustee company in its capacity as trustee. It may well be that when the issue arises the Courts will hold that such a duty exists, but, for the time being at least, it remains to be established.⁸⁰

There are circumstances where courts are prepared to look behind the corporate entity appointed as trustee to the persons who actually control it. These circumstances include where the company is being used as an instrument of fraud or where it is being used for persons to avoid their legal liabilities. However, courts are generally reluctant to lift the corporate veil. The Review has concluded that the duties and liabilities of the members of the board of a responsible entity should not be able to be diminished merely by its incorporation. Because the responsible entity's sole function is to manage the superannuation scheme on behalf of the members the directors of such a corporation should have a personal liability to the beneficiaries of the superannuation scheme in the same way that the directors of a trustee company are personally liable for their handling of estates and other property where they act as trustee.⁸¹

Recommendation 9.3: Fiduciary obligations of members of boards of management of incorporated responsible entities

The law should provide that each member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST owes to the members of the fund, ADF or PST the obligations set out in recommendation 9.2, changing what needs to be changed. In the case of a responsible entity that is a body corporate, this is in addition to any other obligation that he or she owes as director or officer of the body corporate.

78. *Bath v Standard Land Company Limited* [1911] 1 Ch 618.

79. *Bath v Standard Land Company Limited* [1911] 1 Ch 618 at 636.

80. *Hurley & Anor v BGF Nominees Pty Ltd* (1982) 1 ACLC 387, 390-391.

81. *eg Trustee Companies Act 1964* (NSW) s 31(3).