# CORPORATE OWNERSHIP AND CONTROL IN THE FINANCIAL MARKETS

**GEOFFREY NICOLL***

**ABSTRACT**

This paper argues that the different character of the legal ownership (trusteeship) and control (investment management) of funds remains evident today, despite the many overlapping trust and corporate features of the superannuation fund and the corporate entity responsible for managed investments. paper argues that the different character of the legal ownership (trusteeship) and control (investment management) of funds remains evident today, despite the many overlapping trust and corporate features of the superannuation fund and the corporate entity responsible for managed investments.

## I INTRODUCTION

In 1981, RC Clark wrote 'The Four Stages of Capitalism – Reflections on Investment Management Treatises'.[1] In this important work, he traced the four stages of capitalism through a history of corporate ownership and control. In the first and second stages of Clark's capitalism, the owner of the private firm or corporation is also its manager. As the larger corporation rises to prominence however, the corporate manager assumes greater control of capital provided by the owner/shareholder - the familiar thesis of Berle and Means.[2] Both these early stages of capitalism have helped

---

* Geoffrey Nicoll BA, LLB (ANU); PhD (Syd).

[1] R C Clark, 'The Four Stages of Capitalism – Reflections on Investment Management Treatises', (1981) 94 *Harvard Law Review* 561-582.

[2] A A Berle and G C Means, *The Modern Corporation and Private Property* (Macmillan, 1932, Rev. ed. 1967) 1932.

lay the foundations for an era of managerialism which has encompassed agency theory in financial economics and preceded modern corporate governance.[3]

By contrast with these first two stages of capitalism, stages three and four in Clark's work suggested the significance of the financial markets and investment intermediaries, rather than the corporate form, in separating the ownership and control of capital. Writing in 1981, Clark considered that investment intermediaries were likely to garner control of investment funds and corporate capital from the beneficial owner of that capital in the third stage, although he expressed some difficulty in characterising the fourth stage. He speculated that the fourth stage might herald the rise of the 'savings planner' (or investment adviser) who seemed the most likely to secure ultimate control of investment capital from investors. Thus, the four stages of capitalism reflected three distinct steps in distancing the ultimate provider of capital from the control of that capital, and from corporate control when investing in corporations.

Clark's thesis has proven a remarkably close predictor of the way in which the ownership of Australian superannuation funds and their substantial control through investment intermediaries and financial products has evolved since 1997, when the Final Report of the Financial System Inquiry was published.[4] A consideration of key events in the evolution of the Australian financial system since 1997 suggests that the

[3] M C Jensen and W H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) *Journal of Financial Economics* 305-360; The division of corporate powers between the board (and management) on the one hand and the general meeting on the other is now reflected in s 198A of the *Corporations Act 2001* (Cth) and routinely adopted as a replaceable rule in the constitutions of most corporations.

[4] *Financial System Inquiry Final Report* , (Chair: S Wallis), Commonwealth of Australia, 1997.

essentially different character of the legal ownership (trusteeship) and control (investment management) of funds remains evident - despite the many overlapping trust and corporate features of the superannuation fund and the corporate entity responsible for managed investments.

When superannuation funds choose to invest in the shares of public companies as an asset class, as is now commonly the case, the different character and legal responsibilities assumed by the trustee and the investment manager become more clearly defined, giving rise to potential tensions in corporate monitoring and corporate governance. In particular, the ultimate responsibility of the trustee for an investment in shares to the ultimate beneficial owners of those shareholdings rests upon trust law. By contrast, the responsibilities of the investment manager, although now absorbing marked trustee responsibilities, have been cast essentially as corporate responsibilities.

As was foreshadowed in the Final Report of the Financial System Inquiry, superannuation funds now provide the well-spring for a vast new range of investment forms and products.[5] Further, pooled superannuation trusts and master trusts, organised as managed investment schemes under Chapter 5C of the *Corporations Act 2001* (Cth), lay the foundations for an expanded range of hedge funds, private equity funds and sovereign wealth funds in international markets. Most of these sources of corporate capital utilise in some measure the pool of savings now available for investment in superannuation funds. While the new financial products on offer in

Australia do extend the investment choices open to superannuation funds and their members, such investment choices when exercised through new investment products and vehicles also tend to distance fund members from the ultimate control over investment funds, and from participation in the corporations in which those funds may be invested as shareholders.

These developments suggest the growing need to better define the roles of the trustee and investment manager in corporate governance. They also suggest new issues associated with the ownership and control of investment funds and, possibly, with the ownership and control of the corporations in which these funds invest. Because markets operate internationally, the obscuring of the ownership or control of major corporations through investment vehicles and products, such as hedge funds; private equity funds; and sovereign wealth funds, now gives rise to even more significant international issues on this front.

Throughout the 1990s, one expectation of corporate governance was that pension (or superannuation) funds, acting as major shareholders for beneficial interests in the funds, might represent a wider range of stakeholder interests in monitoring corporate governance and corporate responsibility.[6] But such faith in superannuation funds monitoring corporate governance appears to have been misplaced. A consideration of the uncertainties of corporate ownership and control within new investment forms and new investment products in the financial markets prompts questions as to whether

---

[5] See above n 4, 77- 81. See also the elements of the *Financial System Inquiry Final Report* , (Chair: S Wallis), Commonwealth of Australia, 1997 'vision', at 13-14.

earlier hopes for corporate responsibility and good corporate governance may not be undone by the heavy dependence of trustees in practice upon investment vehicles and their products in the exercise of their investment powers, and by the increasingly remote beneficial interests represented by those vehicles and products.

## II RISE OF SUPERANNUATION FUNDS AS MAJOR SHAREHOLDERS IN AUSTRALIA

The broad picture of Australian share ownership today reflects the significant dependence of corporations upon superannuation, and superannuation – linked investment funds which have become major corporate shareholders and providers of corporate capital.[7] This pattern of Australian share ownership is now reflected in the dominant position of the major insurance companies which provide superannuation – linked services and products.

The same pattern of share ownership in Australia also reflects the Government's response to a number of fundamental demographic, economic and political phenomena. These phenomena are common to most countries in the western world.[8]

---

[6] See, particularly: M M Blair, *Ownership and Control - Rethinking Corporate Governance for the Twenty-First Century* (The Brookings Institution, 1995). See also: above n 9.
[7] In Australia in 2004, the equity investments of superannuation funds outside life insurance offices represented 46% of their total assets. The figure had been just 29% in 1990. By 2005, equities and units in trusts held by life insurance companies represented 66% of their total assets and by 2004, equities and units in unit trusts held by superannuation funds represented 46% of their total assets. For both life insurance companies and superannuation funds, the growth in their equity holdings since 1990 was very significant, both in absolute terms and relative to their holdings of other assets. Data compiled from the Reserve Bank of Australia, *Statistics: B14 Life Insurance Companies* and *B15 Superannuation Assets Outside of Life Offices*, February 2006.
[8] For valuable accounts of these influences at the time see: M M Blair, *Ownership and Control – Rethinking Corporate Governance for the Twenty-First Century* (The Brookings Institution, 1995); C

The steadily ageing Australian population has required governments to make increasing provision for spending on age pensions and health.[9] For this reason, a privately funded superannuation system has become essential to Australia meeting the financial needs of its ageing population.[10] Importantly, the superannuation system is required to marshal private savings for retirement – requiring in turn, the sound investment of superannuation funds and favourable taxation concessions.[11]

Demographic and welfare constraints upon governments have therefore imposed upon individuals the obligation to save for their own retirement. The capacity of individuals and households to provide for their superannuation has been made possible by growing household wealth, although this has also been accompanied by higher levels of household borrowing.[12] As a result of these different forces, superannuation has largely displaced other forms of savings by households.[13]

In Australia, the first clear recognition of these developments is found in the Final Report of the Financial System Inquiry 1997, which noted the importance of superannuation – both as a new repository of national savings, largely displacing banks in this role, and as a source of investment funds available to finance

---

K Brancato, *Institutional Investors and Corporate Governance – Best Practices for Increasing Corporate Value* (McGraw Hill) 199; Hill J, Submission to the *Inquiry into the Role and Activities of Institutional Investors in Australia*, Canberra: Parliamentary Joint Committee on Corporations and Securities, 1994, 62. For a more succinct version, see: 'All Capitalists Now', *The Economist*, 25-31 October 1997, 69.

[9] See: The Treasury, *Overview to the Australian Government's Intergenerational Report,* Canberra: Budget Paper No 5, Budget Papers 2002-2003, 6.

[10] Blair above n 8.

[11] Ibid.

[12] Productivity Commission, *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation,* Canberra: Report No 18, AusInfo, 2002 at xvi.

[13] *Financial System Inquiry Final Report*, above n 4, 13.

corporations.[14] The Financial System Inquiry recognised the extent of 'disintermediation' within the Australian market, with the role of traditional institutions being displaced by new investment products and services, and by new markets providing direct access to such products and services.[15] As a result, the role of such intermediaries was seen to be diminishing with new products and market access making more choices directly available to consumers.[16]

Responding to the disintermediation of financial institutions foreshadowed by the Financial System Inquiry, both banks and insurance companies quickly positioned themselves through a series of re-structures and strategic alliances to share in the growing wealth and investment management business associated with superannuation. A number of major insurance companies have de-mutualised, in part to offer fee-earning investment management and trust administration services to other superannuation trustees.[17] They offered new investment products such as pooled superannuation trusts and master trusts to smaller superannuation trustees.[18] Banks

---

[14] Ibid, 1-13.
[15] The most evident institutional control over superannuation funds appears to be occurring in their stranglehold on master trusts, pooled superannuation trusts and wrap accounts. These are the investment 'platform' products into which small superannuation trustees must invest. See: below n 18. See also: R Bowerman, 'The Turn of the Screw', *Asset*, May 2002, 36-42.
[16] *Financial System Inquiry Final Report*, above n 4, 8.
[17] Virtually all the major Australian life insurance companies subsequently changed their status from mutual companies limited by guarantee to companies limited by shares. National Mutual demutualised in 1995 and AMP in 1998. One by-product of de-mutualisation was the generation of new business in offering investment management products and services. The value of the demutualisation of National Mutual Holdings (NMH) to the growth and returns of National Mutual Funds Management (NMFM), one division of MMH, was noted by the chief executive of NMH at the time. See: B Madden, 'Team Effort Lifts NMFM to Winning Way', *Money Management,* 30 October 1997, 13. The commercial importance of managed funds, relative to life insurance funds was also cited as a factor in AMP's decision to demutualise.
[18] One early reflection of this was the phenomenal growth reported in the funds invested in 'platform products' such as master trusts. Together, master funds and wrap accounts reportedly attracted net inflows of $6 billion in the June quarter of 2002. At the end of June 2002, a total of $138.4 billion had been invested through Master Funds and wrap accounts. See: S Hoyle, 'The Big Boys Rule This Market, OK?' *The Australian Financial Review,* 12 September 2002, 16. These master trusts, or

aligned themselves with investment managers as their deposit-taking business dwindled.[19] Both banks and insurance companies created a range of new retail and wholesale investment management and personal superannuation products.[20]

## III SUPERANNUATION FUNDS AS THE FOUNT FOR NEW INVESTMENT PRODUCTS

The importance of accumulating savings in superannuation funds to enable individuals to meet retirement needs has had another important effect that may in some measure be related to the credit bubble that has given rise to the Global Financial Crisis. In order to provide for their retirement, Australians appear to be accepting higher levels of risk in the investment of their savings. As a result, a greater proportion of household savings is now invested in shares, both directly and indirectly, through investment-linked superannuation. The extent to which superannuation and investment funds do now represent individual and household savings is apparent first, in the access of more individuals to superannuation funds;[21] second, in the broader range of superannuation funds and savings accounts now

---

'platform' investment products, are offered usually by the largest insurance companies and banks and provide access to a wider range of investments for the smaller superannuation trustees of corporate employer-sponsored funds and industry funds. A marked feature of the figures in the ASSIRT *Market Share Report*, cited by Hoyle, is the size and dominance of the top nine institutions in this market.

[19] In 2002, Westpac acquired Rothschild Australia Asset Management See: A Hughes, 'Westpac Buys Rothschild', *The Sydney Morning Herald*, 24 April 2002, 21.

[20] See above n 17.

[21] *Superannuation Industry Overview* (2011) APRA <www.apra.Government.au/insight/home.cfm>. 88% of all Australian workers are now covered to some extent by superannuation. Almost 50% of those covered are members of retail funds and 30% are members of industry funds. The remaining 20% are members of employer-sponsored corporate funds, public sector funds and small funds.

available;[22] and third, in the control increasingly sought by fund members over the investment of the superannuation funds held on their behalf.[23] These strong links between household savings and superannuation, and between savings and investment, are confirmed in the Government's recognition of the community's '… strong interest in the prudent management and supervision of superannuation funds'.[24]

The essential steps through which superannuation funds are first pooled into Pooled Superannuation Trusts and Master Trust 'platforms' and then re-invested as managed investments is demonstrated diagrammatically in Figure 1 below. Figure 1 maps broadly the four stages through which lines between financial investment institutions and their products are now easily blurred – one central finding of the Financial System Inquiry.[25] Figure 1 also shows the way in which legal distinctions drawn in characterising funds as 'superannuation' or 'investment' funds, or as 'wholesale' or 'retail' funds, may be increasingly artificial. This in turn suggests that differences in the actual risk assumed by retail investors and the beneficiaries of superannuation funds may also be narrowing.

---

[22] These include superannuation funds designated as Corporate, Industry and Public Sector funds respectively. However, there are also Retail Funds, Small Funds, Statutory Life Insurance Funds and Retirement Savings Accounts (RSAs). The Trustees of Corporate, Industry and Public Sector funds are regulated under the *Superannuation Industry (Supervision) Act 1993* (Cth).

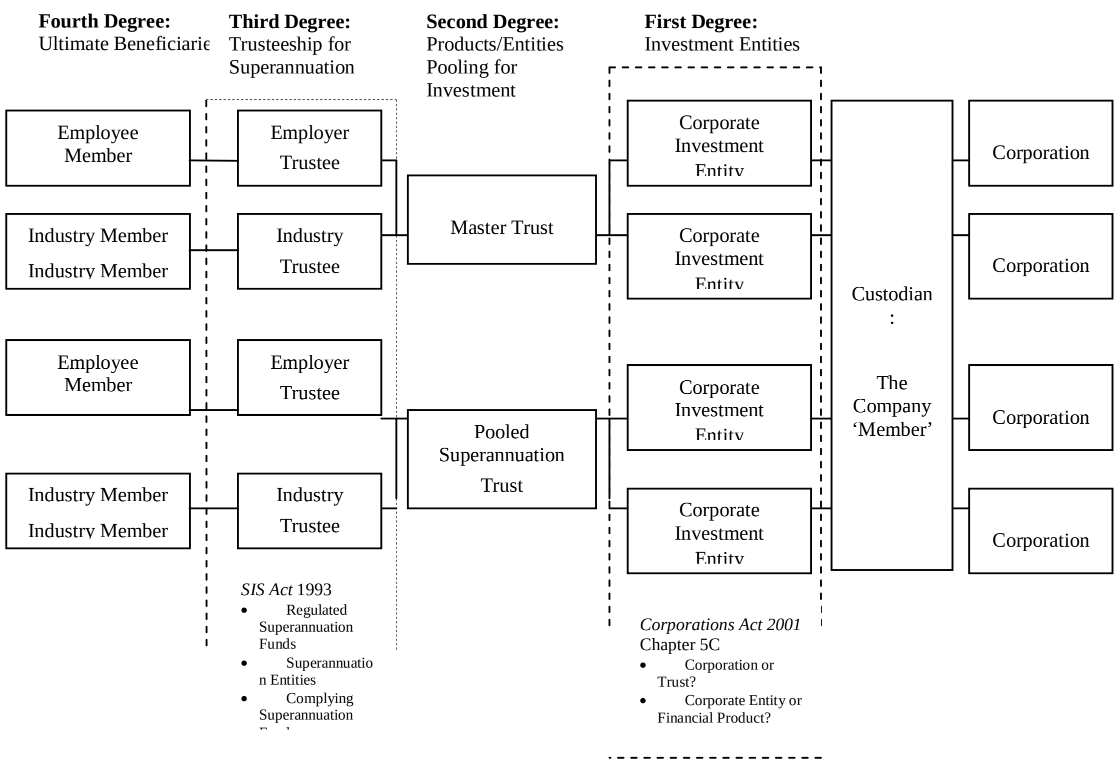
[23] The *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* (Cth), foreshadowed since 1998, was finally passed in June 2004 and came into effect from 1 September 2005. There is evidence on other fronts suggesting that members will seek greater control over the investment of their own superannuation funds. Employer-sponsored funds must make provision for the equal representation of employer and employee representatives upon the boards of the corporate trustees of such funds. *Superannuation Industry (Supervision) Act 1993* (Cth), Part 9, s 89. Public offer funds have tended to grow at the expense of corporate and public sector funds (APRA, *Superannuation Industry Overview*, above n 12, 12). Likewise, there has been a significant growth in the popularity of self-managed DIY funds: J Wasiliv, 'Fund Growth Recovers after Regulation Switch', *The Weekend Australian Financial* Review, 8-9 February 2003.

[24] Productivity Commission, above n 12, 14.

[25] *Financial System Inquiry Final Report,* above n 4, 13.

Importantly to the central theme of this article, Figure 1 also suggests the potential difficulties now likely to be found in distinguishing between the ownership of corporate ‘securities’ (particularly shares) and the ownership and control of the superannuation and investment funds now investing in corporate securities through a variety of ‘financial products’.

**Figure 1: Four Degrees of Separation in Corporate Ownership and Control**




## A Legal character of the superannuation trustee as shareholder

Owing to the fact that superannuation funds may now indirectly represent a range of broad public interests in corporations, a great deal has been expected of the trustee, not merely as a financial institution and investor but also as a major shareholder.

Throughout the 1990s pension funds in the United States became activist shareholders around the world. Beginning with a more active interest in employees' wages and conditions, pension funds by the late 1990s were seen as potentially representative of broader public interests and causes. Commentators such as Margaret Blair saw this as an important development in redressing the 'myopia' of assumptions that the only appropriate social purposes of corporations could be that of maximising shareholder value.[26]

In this respect, pension funds might be thought representative of 'stakeholder', as distinct from 'shareholder', interests. As we have seen, one difficulty in the superannuation trustee actually representing such interests in practice as an active shareholder is the trustee's dependence upon investment managers and their products in practice. Commentators such as Ford and Worthington provide an excellent account of the very substantial difficulties posed by this fact in the context of former public unit trusts.[27] Many of these same difficulties might be valuably considered afresh in the similar context of the relationship today between the superannuation trustee and investment manager, or in reconciling the trust and corporate responsibilities of the corporate entity responsible for managed investments.

One threshold consideration is that the interests represented by superannuation funds under the *SIS Act 1993* (Cth), and the capacity of the superannuation fund trustee to represent those interests as shareholder, rest ultimately upon several constitutional

[26] See above n 7.
[27] H A J Ford and S Worthington, 'Public Unit Trusts' in *Subtitle 4.8, Laws of Australia*, (Sydney: LBC Information Services).

sources of power within the Constitution. By reference to the Commonwealth's pensions powers,[28] the primary purposes of the superannuation trust are to make provision for the retirement of employees from employment, and related purposes. These constitutional powers underlie the core and ancillary purposes stated in s 62 of the *SIS Act 1993* (Cth). However, the Commonwealth's taxation power is also invoked to provide many of the taxation benefits and financial incentives needed to encourage private contributions to superannuation funds.[29] This same power also provides the important constitutional foundation for the regulation of superannuation funds in the *SIS Act 1993* (Cth).[30] In order to qualify for taxation benefits, the fund must be a 'regulated' and 'complying' fund within the meaning of those terms in the Act.[31]

Part 7 of the Act sets out certain provisions which are to apply only to 'regulated' superannuation funds. Section 19 details the requirements that must be met for a fund to be treated as a regulated superannuation fund. Subsection 62(1) of the Act requires that the trustee of a regulated superannuation fund must ensure that the fund is maintained solely for one or more of a number of 'core' purposes,[32] or for one or more of a number of 'ancillary' purposes.[33] It is clear that these core and ancillary purposes are directed to providing benefits for the members of superannuation funds in the event of a member's death, retirement or termination of employment.

---

[28] The *Constitution*, ss 51(xxiii) and 51(xxiiiA).
[29] The *Constitution*, s51(ii).
[30] A regulated superannuation fund has complying fund status for taxation purposes if it complies with Part 5, Division 3 of the *Superannuation Industry (Supervision) Act 1993* (Cth).
[31] See above n 28.
[32] *Superannuation Industry (Supervision) Act 1993* (Cth), s 62(1)(a).
[33] *Superannuation Industry (Supervision) Act 1993* (Cth), s 61(1)(b).

Such core and ancillary purposes suggest the reasons why the trustee of a superannuation fund might be seen as a different type of shareholder – one possibly representative of broader public interests in employment, welfare and health. At the same time of course, the core and ancillary purposes of superannuation funds also suggest the reasons for intense governmental and political interest in superannuation funds and their investment.

There are however, two significant obstacles to superannuation trustees pursuing broader social objectives on behalf of members. The first obstacle has been the way in which the trustee's investment power in law has been construed in the light of the need to actively manage large trustee funds for investment – particularly in corporate shareholdings. The central issue in this area was foreshadowed in *Cowan v Scargill*, a case decided in the English Chancery Court in 1985.[34] The case has not received close consideration in subsequent case law. The presiding judge, the Rt. Hon. Sir Robert Megarry, later offered one reason why this has been so – suggesting that the case displayed no 'bold novelty of approach' owing in part to the fact that the defendant trustees represented themselves so that more difficult issues were not put to the Court in the alternative.[35] Nevertheless, in deciding that the investment powers of the pension fund trustee should be exercised only for the *financial* ends of beneficiaries, rather than for any broader political or public purpose, the case laid important judicial

[34] *Cowan v Scargill* [1985] Ch. 270 (the *Mineworkers' Pension Case*). For an excellent commentary on this case by the presiding judge, see: Rt. Hon. Sir Robert Megarry: 'Investing Pension Funds: The Mineworkers' Case' in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989).
[35] Ibid 152, 159.

ground for the interpretation of the trustee's investment powers in this context. For this reason, the cy of the case is considered in more detail in the next section.

Another reason why the case has not received close attention is this has been an area in which the legal duties of the investment fiduciary have been largely overtaken by the utilitarian economics of market and corporate finance. The work of commentators such as Professors Langbein and Posner has conditioned trustees to accept that they lessen the overall risk of loss when they invest funds through diversified portfolios.[36] The statutory duties of the investing trustee in this context have been significantly conditioned by this thinking and by the efficient market hypothesis.[37] In the Act, s 52(2)(f) now requires the trustees of superannuation funds to diversify investments in their formulation of an investment strategy and this is largely seen by them as an answer to their legal duties in the exercise investment powers. Nevertheless, there remains an uncomfortable question as to whether the essentially personal duty imposed upon trustees in subs 52(2)(b) is satisfactorily answered by the essentially corporate approach to risk management articulated in s 52(2)(f) for superannuation trustees investing in corporate securities.

## B The legacy of Cowan v Scargill

[36] Langbein and Posner, 'Market Funds and Trust Investment Law' (1976) 1 Am. Bar Found. Res. J; and 'Social Investing and the Law of Trusts' (1980) 79 Mich. L. Rev. 72. See also: Gilson and Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 Va. L. Rev. 549 at 549-550. For an Australian consideration of these articles see: WA Lee, 'Modern Portfolio Theory and the Investment of Pension Funds' in PD Finn (ed), *Equity and Commercial Relations* (The Law Book Company Limited, 1987).

[37] See particularly the statutory covenant now imposed upon the investing superannuation trustee under s 52(2)(f). See further below.

One significant limitation upon the capacity of the superannuation trustee to represent broader public or political interests as a major shareholder in corporate law is found in the enduring judicial significance of one English authority. The 1985 decision of the Chancery Court in *Cowan v Scargill* first suggested the tensions that were likely to arise in assessing the proper purposes of pension fund trustees who were required to provide for the beneficiaries of the Mineworkers' Pension Scheme (the Scheme) established in the United Kingdom.[38] The question for the Court was whether those purposes should be considered to be only the *financial* benefits of the beneficiaries (considered apart from any political or other objections that might be raised as to the way in which those financial benefits were derived), or whether the trustees' proper purposes in investing the funds of the Scheme might be taken to include the social and political purposes of the National Union of Mineworkers at a time of bitter dispute between the Union and the British government over mine closures.

In *Cowan v Scargill*, the Court declared that the proper purposes of the trustees in law should be considered only the financial benefits of the trust beneficiaries. The Mineworkers' Pension Scheme had been set up jointly by the National Coal Board and the National Union of Mineworkers in order to provide pensions and lump sum payments to the widows and children of mineworkers, and payments to workers suffering injuries and diseases. The Scheme enjoyed a number of taxation advantages in order to provide these benefits. In the supervision of the Scheme, there were 10 trustees – five of whom were appointed by the National Coal Board and five by the Union. The trustees enjoyed wide powers of investment and there was established a

[38] *Cowan v Scargill* [1985] Ch. 270 (the *Mineworkers' Pension Scheme Case*).

Joint Investment Sub-Committee (JISC). The trustees held the power to act by majority, but no allowance had been made for a casting vote.

In 1976 there was instituted an initial four-year plan for the investment of the Scheme funds, although this was replaced in 1980 by a similar plan permitting three classes of investment namely: marketable securities; land; and industrial finance (including equities in small listed companies).

In 1982, a further revised plan proposed that an increased proportion of the Scheme funds might be invested overseas. Approval by the JISC was sought for this revised plan and immediately encountered difficulties. Joe Gormley, the President of the Union, had resigned one month earlier and Arthur Scargill had been elected in his place as both a Union trustee of the Mineworkers' Scheme and as the Vice Chair of the JISC. At a time of bitter dispute with the British government over mine closures, Scargill maintained that, as a point of investment principle, there should be no further investments of Scheme funds overseas in any form of energy that competed with British coal. Any investment in oil in the United States might be seen as such a competing investment. Scargill was supported in this contention by the four trustees appointed by the Union, but was opposed by the other five trustees. As a result, the board was equally divided and deadlocked on the issue.

The matter came before the Court on the issue of whether the defendants (who were the union appointed trustees) were in breach of their fiduciary duties as members of the JISC and trustees of the Scheme in their refusal to adopt the Revised 1982

Investment Plan. The case took nine days to decide. Of the five defendants, only Scargill addressed the Court. He provided a one and a half page affidavit setting out the case for the defendants. In his subsequent commentary, the presiding judge noted that more difficult issues may have received closer attention in argument had the defendants been represented.[39]

Leaving this to one side, the case was argued on three principal points of law which were considered by the Court.[40] The defendants did not contest the stated law on these points. Firstly, it was argued that the paramount duty of the trustees was to exercise their powers in the best interests of the beneficiaries.[41] Where the object of the trust is to provide financial benefits for the beneficiaries, as in this case, those best interests would be considered normally (but not inevitably) their best financial interests. Secondly, in deciding on investments trustees must ignore their own personal views and interests and not refrain from making an advantageous investment merely because they are personally opposed to the activity involved. At the time of the decision in *Cowan v Scargill*, investments in alcohol, tobacco or armaments sold to South Africa at the time of the apartheid regime provided examples of investments to which personal objections might have been otherwise raised on this ground. Finally, there was the duty of a trustee in making investments to take such care as an ordinary prudent man would take when making an investment for another person for whom he

---

[39] Ibid, 152-153.
[40] See also, the subsequent commentary on these points offered by the presiding judge, the Rt. Hon. Sir Robert Megarry above n 34, 154.
[41] The 'convenient phrase' utilised in the American case of *Blankenship v Boyle* (1971) 329 F. Supp. 1089 (Dist. Ct. D.C.) and cited in: *Cowan v Scargill* (see: above n 34), 292 was the 'duty of undivided loyalty to the beneficiaries' owed by the trustee.

felt morally bound to provide – a requirement reflected in the trustee's statutory covenant under s 52(2)(b) in the *SIS Act 1993* (Cth).

The Court saw the question as one of whether these principles were to apply without modification in this case. The plaintiffs maintained that the answer to this question should be yes; the defendants, no.

In the final result, the Court made the declaration sought by the plaintiffs and the defendant trustees were declared in breach of their fiduciary duties in refusing to adopt the Revised 1982 Investment Plan (unless that Plan included specific prohibitions on investments in oil and other coal alternatives). The effect of this decision is still felt today in the primacy of trustee investment decisions for the financial benefits of the beneficiaries. An extension of the principle endorsed in the case is now found in the statutory acceptance of diversified portfolio management as a discharge of the trustee's legal duties in the exercise of investment powers.

### C Trustee's duties in the exercise of investment powers

A number of provisions found in *the Superannuation Industry (Supervision) Act 1993* (Cth) illustrate the continuing influence of trust law upon superannuation funds and their trustees. A 'superannuation entity' is defined in s 10 of the Act to mean a regulated superannuation fund, an approved deposit fund, or a pooled superannuation trust.[42]

In the Act, Part 6 sets out the legal responsibilities or 'covenants' of the trustee with respect to the governing rules that are applicable to superannuation entities. Subsection 52(2) sets out the covenants which are deemed to be included in the governing rules of a superannuation entity when such covenants are not actually included in the rules. It is worth setting out in full the requirements in these covenants because there is no mistaking the distinctive obligations of the trustee in safeguarding trust property, and in providing the end benefits due to beneficiaries.

The distinctive obligations of the trustee are particularly evident in paragraphs 52(2)(b) and 52(2)(f). Section 52 states:

> 1) If the governing rules of a superannuation entity do not contain covenants to the effect of the covenants set out in subsection (2), those governing rules are taken to contain covenants to that effect.
>
> The covenants
>
> 2) The covenants referred to in subsection (1) are the following covenants by the trustee:
>
>    a) to act honestly in all matters concerning the entity;
>
>    b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide;
>
>    c) to ensure that the trustee's duties and powers are performed and exercised in the best interests of the beneficiaries;

[42] Interesting issues may arise as to the precise legal status of the pooled superannuation trust. Pooled superannuation trusts are constituted as unit trusts and regulated as superannuation entities. However,

d) to keep the money and other assets of the entity separate from any money and assets, respectively:

   i) that there are held by the trustee personally; or

   ii) that are money or assets, as the case may be, of a standard employer-sponsor, or an associate of a standard employer-sponsor, of the entity;

e) not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;

f) to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following:

   i) the risk involved in making, holding and realising, and the likely return from, the entity's investments having regard to its objectives and its expected cash flow requirements;

   ii) the composition of the entity's investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification;

   iii) the liquidity of the entity's investments having regard to its expected cash flow requirements;

   iv) the ability of the entity to discharge its existing and prospective liabilities;

g) if there are any reserves of the entity – to formulate and to give effect to a strategy for their prudential management, consistent with the entity's investment strategy and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due;

h) to allow a beneficiary access to any prescribed information or any prescribed documents

---

they are also, in the eyes of major institutions, an investment product.

In these provisions it is quite clear that the essential legal obligations of the superannuation trustee, which will be generally constituted as a corporation, remain those of a legal trustee. The duties imposed upon the superannuation trustee clearly differ in fundamental ways from those imposed upon a director under the *Corporations Act 2001* (Cth). For example, under the *SIS Act 1993* (Cth) the trustee is required to act 'honestly' in all matters relating to the superannuation entity (s 52(2)(a)). By contrast, the former duty upon corporate directors to act 'honestly' has been re-formulated as a duty to act 'in good faith, for proper purposes and in the interests of the company' – a formula more closely aligned to the purposes of directors, more easily enforceable through an enhanced range of civil penalty provisions and more attuned to the demands of modern corporate governance.[43] Similarly, while the superannuation trustee under the Act is required to perform duties and exercise powers 'in the best interests of the beneficiaries' (subs 52(2)(c)) the corporate director is required to act 'in the interest of the company'. Thus, the legal obligation owed by the superannuation trustee to the 'members' of the fund, rather than to the fund 'as a whole', is conceived as a personal obligation of the trustee rather than as a corporate obligation.[44]

The seemingly onerous obligations imposed upon the superannuation trustee may be exceedingly difficult for the trustee to discharge in practice as a major investor and shareholder. The trustee's obligation in s 52(2)(b) to exercise the same care and

---

[43] *Corporations Act 2001* (Cth), s 181.
[44] S*uperannuation Industry (Supervision) Act 1993* (Cth), s 52(2)(c). This obligation seems particularly onerous when the trustee must represent both the political interests of employers and employees in industry superannuation funds, and the financial interests of members. In law, the latter interests should generally prevail. See: *Cowan v Scargill* [1985] Ch. 270.

diligence '... as an ordinary prudent person might exercise in dealing with the property of another for whom the trustee felt morally bound to provide' reflects a personal expectation of the trustee which may be unrealistic for a corporate trustee responsible for investing large superannuation funds – given the high dependence of the trustee on the investment manager.[45]

There are tensions here between traditional concepts of corporate and trustee responsibilities. At the heart of these tensions lies the fundamental difficulty posed by a superannuation trustee meeting onerous personal obligations to beneficiaries in safeguarding trust property while also adopting a corporate-style approach to risk management in pursuing returns from higher performing investments in the market.[46] This difficulty is now highlighted in s 52(2)(f) which enables the trustee to answer its investment obligations through the formulation of a strategy founded upon investment diversity and portfolio management theory. In the requirements for the appointment of investment managers the *SIS Act 1993* (Cth) envisages some separation between the legal ownership of the superannuation fund and the management of the fund as an investment.[47] In these provisions however, while the superannuation trustee is envisaged the dominant party in the contractual relationship with the investment

[45] S*uperannuation Industry (Supervision) Act 1993* (Cth), s 52(2)(b). Such an obligation upon the superannuation trustee seems particularly unrealistic when the trustee is heavily dependent upon investment products such as master trusts or pooled superannuation trusts, when making an investment. The same point arose in considering the legal responsibilities of the trustee in the former public unit trust.

[46] S*uperannuation Industry (Supervision) Act 1993* (Cth), s 52(2)(f).

[47] Section 124 of the S*uperannuation Industry (Supervision) Act 1993* (Cth) provides that investment managers must be appointed only in writing, and s 125 provides that the investment manager must be an incorporated body. Section 116 provides that any agreement between the trustee of a superannuation entity and the investment manager of that entity must not exempt the investment manager from liability for negligence, nor limit the extent of the manager's liability in this regard. Section 122 provides that an investment manager must not appoint or engage a custodian without the trustee's consent.

manager, the reality will often be that the trustee depends upon the expertise of the manager and the manager's products – a reality analogous to the relationship between the trustee and management company in former public unit trusts. [48]

The analogy with public unit trusts is an interesting one, since the investment manager today is increasingly likely to be a corporate entity responsible for managed investments.[49] This entity is itself a single legal corporation in which the separate functional roles of the trustee and the management company in former public unit trusts were merged in 1998. The single corporate entity responsible for managed investments was conceived as a result of the difficulties found in articulating the separate roles and responsibilities of trustees and management companies in former public unit trusts.[50] The abolition of the trustee in 1998, and the compression of the trustee's responsibilities into the constitution of the new corporate entity, has seen the former trustee's duties in trust law incorporated in the governance of the entity.

## IV CONTINUING TENSIONS IN THE ROLES OF SUPERANNUATION FUND TRUSTEES AND INVESTMENT MANAGERS AS CORPORATE SHAREHOLDERS

It may be appreciated from the discussion above that developments in the Australian financial market since the FSR in 1997 have essentially followed the course predicted

**48** Ford and Worthington, above n 27.
49 *Corporations Act 2001* (Cth), Chapter 5C.

by Clark although the institutional role of market intermediaries has perhaps diminished. In an attempt to offer greater consumer choice in the investment of their superannuation savings, the members of funds now have more direct access to markets through a widening range of investment products which has blurred the lines between intermediaries and their products.

The effect of these developments has been much the same as Clark predicted, however, since the members of funds have become increasingly removed from any investment of their funds that might ultimately be made in corporations. As a result, they now depend substantially upon superannuation trustees and corporate investment managers as the owners and controllers of their capital to protect their interests in corporate governance. For this reason it is important to consider closely the powers and responsibilities of trustees and investment managers as major corporate shareholders and the role each might play in corporate governance.

As has been seen, although there are now significant borrowings from trust and corporate concepts on each side, it is still possible at certain points to identify the essentially different roles played in practice by the superannuation trustee (as the ultimate legal 'owner' of shares) and the investment manager (as the 'controller' of those shares).[51] These different roles are suggested in the ways in which the 'trustee'

---

[50] The Explanatory Memorandum to the Managed Investments Bill 1997 (Cth) cited the breakdown of market information available to the trustee as one compelling reason for establishing a single responsible entity in the place of the trustee and management company in former public unit trusts.

[51] It should be noted, referring to Figure 1, that this analysis ignores the important role played in practice by the 'custodian' as the legal 'member' of the corporation. The custodian acts generally under the instructions of the trustee or investment manager in issues of corporate governance and difficult issues arise as to the exercise of voting rights at the meeting. This provides a further 'agency cost' to trustee participation, but one that has been ignored for the purposes of this article.

character of the superannuation fund trustee and the 'corporate' character of the investment manager are emphasised in the two different legal forms. Legally, the superannuation trustee remains a trustee although it is often constituted as a corporation for the purposes of the *SIS Act 1993* (Cth) while the corporate responsible entity is essentially a corporation, albeit one with distinctive trustee characteristics,[52] and more refined features of corporate governance.[53] In practice, while the superannuation trustee must consider the overall investment strategy, the responsible entity is focussed upon investment returns and is likely to be closer to the market and corporate management in the case of corporate investments.

For a period in the 1990s, the active role of United States pension fund trustees was greatly encouraged in the interests of overseeing management and promoting superior market performance among investee corporations.[54] This active role was even considered one which might extend to trustees playing a more active role on corporate boards and in the oversight of management. This was a time of high expectations for the pension (or superannuation) fund trustee. However, any expectation that the trustee might play such a role has largely faded. In 1998, Professor Black summarised

---

[52] For example, s 602FC(2) provides that the property of an investment scheme managed by the responsible entity is to be held on trust for scheme members. Likewise, ss 601 FC(1) and 601FD(1) stipulate that the duties of the responsible entity and its officers respectively are to act in the best interest of scheme members as distinct from any corporate or scheme entity.
[53] An example being the requirement in Part 5C.5 that a compliance committee be established when less than half the directors of the responsible entity are 'external' directors. Section 601JC endows the compliance committee with a novel statutory role in reporting to ASIC if it believes the responsible entity has not taken action, or does not propose taking action, with respect to breaches in relation to the management of a scheme.
[54] The leaders in this respect were a group of active public employee pension funds such as the Californian Public Employees' Retirement System (CalPERS). In 1998 CalPERS announced a strategic alliance with Hermes Lens and other large institutional investors who were particularly keen to monitor corporate performance and remuneration issues. See: S Davis, 'CalPERS, Hermes Ally' (1998) 2(43) *Global Proxy Watch* 43. Since then, CalPERS has played an active role in the International Corporate

the reasons for this and the failure of pension fund trustees as active shareholders in the United States in these terms:

> A small number of American institutional investors, mostly public pension plans, spend a trivial amount of money on overt activism efforts. They don’t conduct proxy fights, and rarely try to elect their candidates to the board of directors. Legal rules, agency costs within the institutions, information costs, collective action problems, and limited institutional competence are all plausible partial explanations for this relative lack of activity. The currently available evidence, taken as a whole, is consistent with the proposition that the institutions achieve the efforts of firm performance that one might expect from this level of effort – namely, not much.[55]

Not only has it become difficult to see the trustee playing a truly active role as a major shareholder in the companies in which it invests, it is becoming difficult to define the roles that superannuation trustees and investment managers might play in corporate monitoring. Apart from the role routinely played annually in monitoring corporate performance and management remuneration, public intervention by superannuation trustees in corporate governance is becoming more sporadic and more muted. Perhaps the last real example of such intervention in Australia occurred in 2004 when the Australian Council of Superannuation Funds sought and obtained assurances from Newscorp Ltd that hard-won features of corporate governance adopted by Newscorp

---

Governance Network (ICGN), reflecting the close identification of the ICGN’s approach to corporate governance with that of CalPERS and other active funds.

[55] Extract cited from: ‘Recent Surveys of Corporate Governance’, Appendix A in the Conference Board’s 2000 update: *The Link Between Corporate Governance and Performance: Year 2000 Update*, (New York: The Conference Board, 2000).

Ltd in Australia would continue to be respected by the corporation when it re-located to the United States.[56]

In other respects, corporate investment managers have sometimes appeared to exercise considerable influence in their dealings with corporate management. They have also appeared central to the control of major shareholdings in major takeovers. This appeared to be the case, for example, in the context of the proposed bid by the Australian Gas Light Company (AGL) for rival Alinta Ltd in 2006, and the subsequent conditional bid made by Alinta Ltd for AGL. As a result of this bid, Alinta came to hold more than 20% of AGL and in June 2006 both companies entered a Merger Implementation Agreement with a view to merging their infrastructure assets. With Alinta holding in excess of 20% of AGL and the merger of their infrastructure assets clearly in mind, an issue arose concerning the control that Alinta might potentially achieve in its positioning with AGL through its relevant interest in AGL's 30% holding of the issued units in the Australian Pipeline Trust (APT) and its own subsequent acquisition of a further 10% of units in the APT.[57] The APT was strategically significant since AGL's gas pipeline transmission assets were vested in this trust. The APT also constituted a managed investment scheme of which AGL was deemed to be the responsible entity. Between 16 August 2006 and 22 August 2006,

[56]Evidence of the active interest of the Australian Council of Superannuation Funds in the governance and management of News Corp was seen in the Council's actions in 2004 and 2006. In seeking to relocate to the United States in October 2004, News Corp was forced by a group of shareholders, led by the Council, to maintain the same standards of corporate governance that the company had adopted in Australia. In 2006, twelve investor groups, including six Australian superannuation funds, protested that News Corp had breached its 2004 undertakings to shareholders by proposing the extension of 'poison pill' arrangements which would enable the company to block potential takeovers. News Corp agreed to the demands of this group of shareholders and to putting the proposed arrangements to the general meeting for resolution by shareholders. See: 'Murdoch Backflip on Poison Pill Vote', *The Sydney Morning Herald*, 8-9 April 2006, 41.

Alinta acquired approximately 10% of the issued units in APT through its wholly-owned subsidiary Trewas Pty Ltd, prompting AGL to apply to the Takeovers Panel seeking a declaration of unacceptable circumstances because of the effect that Alinta's acquisition of up to 40% of units in the APT might have on its control or potential control of the trust.

The Alinta case suggests the extent to which the control of investment vehicles constituted as managed investments schemes under the *Corporations Act 2001* (Cth), such as the APT, may become significant to the control of corporations in which they invest.

Article 10 of the CTC should be repealed and the requirement of publicity of trust property should be re-examined. It may be justifiable to impose a registration requirement on commercial trusts because the 'caveat venditor' doctrine is entrenched in civilian commercial laws and there is no duty on the part of the buyer to investigate the title to property or the qualification of the seller. The buyer should have all information available to him before dealing with a commercial trust. Disclosure of information is necessary in business. Many trusts are, however, more like private arrangements between the settlor and the trustee (in commercial trusts) or between the trustee and the beneficiaries (in private trusts). The private character of these trusts cannot and should not be compulsorily changed into a public character. Any requirement of publicity for trusts should be confined within a reasonable scope and

---

[57] *Re Australian Pipeline Trust* 01 [2006] ATP 27, 26.

should not distract from the primary aim of a trust law, which is to establish a rigorous regime of fiduciary accountability.

## V CONCLUSION

The heavy reliance of superannuation trustees upon investment managers and their market products suggests that three long-standing legal questions may need further consideration. These three questions are firstly, whether the trustee's reliance upon diversification and portfolio investment in the investment of large superannuation funds provides a wholly satisfactory answer to the trustee's legal obligations in making corporate investments; secondly, whether the trustee and investment manager are now truly able to exercise their investment powers 'in a fiduciary way'; and thirdly, whether the cross-over of corporate and trust forms within the markets sufficiently distinguishes the arguably different roles that might now be assumed by the trustee owner and corporate investment manager in corporate governance.

A consideration of Clark's capitalism in the Australian context suggests that there is some discernable evidence of a continuing separation between the 'ownership' role of the trustee and the potentially 'controlling' role of the investment manager in the management of superannuation funds. While there is now an extensive mixing of trust and corporate forms within the market, the separation between ownership and control begins with important differences in the constitution and legal duties of the superannuation trustee and the investment manager. It is reinforced in the effective dependence of the superannuation trustee upon the investment manager and the manager's products in making investment decisions. This separation between the ownership and control of funds in the financial markets holds particular significance for the investment of superannuation funds in corporate shareholdings.

There are significant tensions here between traditional concepts of corporate and trustee responsibilities. At the heart of these tensions lies the fundamental difficulty posed by a superannuation trustee meeting onerous personal obligations to beneficiaries in safeguarding trust property while also adopting a corporate-style approach to risk management in pursuing returns from higher performing investments in the market. As beneficial owners become more removed from the management of funds and from participation in corporations, the roles of the trustee and investment manager in corporate governance becomes more important. These underlying tensions suggest that the expectations of major trustee shareholders and investment managers in monitoring corporate governance might be undermined by the different perspectives of the trustee owner and the investment manager in investing superannuation funds.