

PROFESSIONALISM AND ETHICS: A LEGAL PERSPECTIVE

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Introduction

1. At the outset, I should offer a disclaimer of expertise in the area of superannuation, particularly the “self managed” species of superannuation. I don’t own or run a superannuation fund. And you will have divined from my career and my appearance that my age disqualifies me from taking advantage of Peter Costello’s Budget generosity by selling assets or borrowing a huge amount of money and putting it into a superannuation fund. In any event, borrowing would be a dubious strategy. The interest payments would not seem to be deductible.

2. But I have some sympathy for those who do manage superannuation funds and for their advisers. My sympathy arises from the regulatory regime which, though simpler than it was, is by no means “user friendly”. My objection is not to regulation as such. It is necessary to regulate superannuation investments in the interests of both the public and superannuitants for the interests of the two groups do not coincide. It is also necessary to have strong regulation, backed by stern sanctions to ensure that the privileges given to those who own and manage SMSFs are not abused. And sanctions need to be stronger in an era, such as ours, where the prevailing ethos is economic rather than ethical and the emphasis is on profits and money-making.

3. But does this regulatory regime need to be quite as complex as it is? For example, statements of advice (SOA) about which I shall have something to say later. Governments of various political persuasions appear to believe that problems can be solved simply by enacting legislation without recognising that the difficulties and costs of compliance are major causes of non-compliance.

4. On the other hand, complexity is inevitably a problem in a system based on self-management. It is not a problem confined to SMSFs. An article in *The Sydney Morning Herald* last week¹ explored the problems associated with strata title properties where size and complexity are significant factors, where the system appears to be experiencing great difficulty in coping with these problems. The article makes the point that poor standards of management and governance are contributing causes. Schemes are governed by volunteer committees whose members have limited skills and few resources.

5. This results in conflicts of interest, poor decision-making and lack of supervision of professional managers. Strata managing agents often lack the skills to provide the required levels of professional service. With SMSFs, fortunately, there is a greater level

¹ Gary Bugden, “Close fit, not close-knit needs better legislation”, *SMH*, 27 February 2007, p. 11.

of professional skill available to assist self-management. Yet surveys to which I shall refer reveal a lower than expected level of professional performance. Our object must be to ensure that professional skills are provided at a high level and that they are in fact accessed.

6. The issue of compliance, always important, has become even more important, since the September 2006 Federal Budget. According to Alan Kohler's *Eureka Report*,² new figures from the ATO show that SMSFs account balances per members have shot ahead by \$54,000 in the 15 months to September 2006 and they will continue to soar. Almost one quarter of Australia's superannuation savings is held in SMSFs. The Report makes the comment that the increase in super money in the 15 months to September 2006 "held by the average DIY fund member represents almost as much as most people have accumulated in their entire lives". I am informed that there now are over 320,000 SMSFs with investments amounting to \$260 billion,³ while superannuation assets now exceed \$1 trillion.

7. I had intended to say that there is a dark cloud on the horizon, referring to increasing policing of the sector by the regulators. But that dark cloud actually descended on the Conference on Wednesday in the person of Michael D'Ascenzo, the Commissioner of Taxation. He announced that the ATO planned to increase its compliance checks on SMSFs. He also said that the ATO would be knocking at the doors of high risk auditors. More positively, he spoke of providing instructive guidance to those conducting SMSFs, guidance which will unquestionably be welcomed. The Government is concerned at the level of compliance by SMSFs with superannuation law and the level of trustee education and understanding of their responsibilities.⁴ This is one reason why compliance issues are now of the utmost importance. And compliance inevitably raises issues of professionalism and ethics.

The rise of professional society

8. Before I refer to professionalism I shall say something about the rise of professional society. The dominant feature of modern English and, for that matter, Australian society, has been the rise of professional society since 1880.⁵ The ascendancy of professional society prevailed until the 1970s when it is said to have gone into decline, the consequences of which are now evident in the criticisms made of the professions, notably the medical and the legal professions.

9. It is by no means clear what is meant by the decline of professional society. There has certainly been a decline in the respect accorded to professional people and their opinions. Clients and patients are now more inclined to question their advisers, to

² Trish Power, "Australia's exploding DIY funds", *Eureka Report*, February 16, 2007, p. 1.

³ These figures are rather larger than those stated by Senator Sherry when speaking on the Parliamentary Joint Statutory Committee on Corporations and Financial Services Report "Statutory oversight of ASIC", Senate proceedings on 1 March 2007, p. 20.

⁴ "Simplified Superannuation – Final Decisions", 10 January 2007.

⁵ See generally H.J. Perkin, *The Rise of Professional Society since 1880*, Routledge (1990).

criticise them and to sue them when things go wrong. And professionals don't enjoy the same status they enjoyed in earlier times. Compared with sporting and entertainment personalities, business leaders, managers, politicians and certainly those "famous for being famous", professional people do not rate highly in the pecking order. The professional person's principal passport to fame is to become "famous for being infamous".

10. On the other hand, if we look beyond the superficial world portrayed by the media, professional life is still flourishing in Australia. One reason for this is that the class of professionals has extended well beyond the traditional categories of doctors, lawyers, dentists, engineers, accountants and others to include a very wide range of occupations backed and supported by university courses and degrees. The extent of that success is evidenced by the great demand overseas for our professionals and our companies offering professional services. The outstanding achievement of our universities has been to produce competent professional graduates in large numbers. This is why we attract so many foreign students.

What it means to be a professional

11. The distinctive and idealistic claim of the professional is that he or she offers a service which is expert in the sense that it is the product of special skill and knowledge and it is provided for the benefit of the client (or patient) and in the interests of the client and not in the interests of the provider except in so far as the provider receives a reasonable remuneration for the service rendered. Generally speaking, it was a characteristic of the professional service that the client or recipient lacked the requisite skill and knowledge to assess the competence of the provider and the worth of the service provided and was therefore forced to take in it on trust. This may well be the situation today with many recipients of SMSF advice.

12. The distinction between a trade, a business or a mere occupation and a profession has often been based on the public service ideal of the professional. Sir Laurence Street said:⁶

"A trade or business is an occupation or calling in which the primary object is pecuniary gain ... But in a profession, pecuniary success is not the only goal. Service is the ideal, and the earning of remuneration must always be subservient to this main purpose."

13. Anthony Trollope, the novelist, was more cynical, describing⁷ a profession as "a calling by which a gentleman not born to the inheritance of a gentleman's allowance of good things might ingeniously obtain the same by some exercise of his abilities".

14. The traditional statements of the professional ideal are deficient in one important respect. They fail to identify the independence of the professional adviser and the

⁶ *Re Foster* (1950) 50 SR(NSW) 149 at 151.

⁷ A. Trollope, *The Bartrams*.

objectivity of the advice which was given, these being two of the qualities which distinguish the true professional from the vendor of a product, whether it be land or goods or something else.

15. The traditional view of a profession has given way, as many traditional views have, to the advance of commercialism. Sir Daryl Dawson noted in 1996⁸ that there had been a transition from “trustee professionalism” (being the use of knowledge in the service of the client or the community) to “expert professionalism” (being concerned with the marketing of expertise *per se*) and its consequences for the ideal of public service. Commentators instance large law firms as examples of “expert professionalism” because they no longer pursue the public ideal. It is then said – and I am not to be taken as agreeing with the statement – that these firms are therefore carrying on a commercial activity in which independence and objectivity are not central elements.

16. There is now an increasing community perception that professionals no longer pursue the professional ideal. To the extent this ideal is invoked by professionals, it may be regarded simply as part of the mystique which the professions call in aid to repel criticism. Some professional people, by their conduct, have contributed to this perception. The failure of a profession to maintain high standards of conduct results in a forfeiture of trust and confidence in the profession.

17. There is also a concern that professional advisers should have done more to shield the community from corporate collapses and other untoward financial problems. In the past, it was expected that professional people – accountants, auditors and lawyers, acting independently, giving sound prudential advice and delivering responsible, objective reports, would act as a brake on the commercial adventurism which has taken place in the United States and Australia in recent decades. In the United States, pointed comments were made about the performance of accountants, auditors and attorneys in the events that led to the collapse of the savings and loans corporations. Later the activities of lawyers, accountants and auditors were instrumental in the dealings which led to the collapse of Enron Corporation, a story which has been graphically documented in “The Smartest Guys in the Room”.⁹

18. In Australia, we had the collapse of the development boom in the late 1980s. Since then we have had the James Hardie affair and the HIH collapse, events which are still being played out in the courts, with no end in sight.

19. In the context of SMSFs, the Federal Government, principally through the ATO, has endeavoured to redress the consequences of this decline in the professional ethos by imposing stern sanctions for non-compliance, by increasing the monitoring and policing of compliance and by undertaking a comprehensive campaign to educate professionals, trustees, managers and members so that they understand their responsibilities. The ATO publications in this area are of high quality, are very informative and are clearly

⁸ Dawson, “The Legal Services Market”, (1996) JJA 147 at 148.

⁹ B. McLean and P. Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*, Portfolio (2004).

expressed. And the SPAA has played a significant part in identifying and encouraging standards of professional excellence.

Professionalism and ethics

20. The events in the United States and Australia already mentioned marked what was a crisis in the decline of professionalism and ethics. Professionalism now signifies high professional standards of competence. On the other hand, ethics signifies high standards of ethical conduct. The attainment of high standards of professional competence is not enough on its own. It is necessary to pursue high ethical standards as well. It is instructive to read what is now alleged against defendants in the James Hardie case. You will recall that the object of the exercise there was to locate the headquarters of the company in the Netherlands. One consequence was to impose a limit on the company's liability to its Australian employees who suffered from asbestosis. It is suggested that there was a failure to inform the court approving the scheme of arrangement that it was contemplated that the company would cancel its uncalled capital. If there was such a failure – and I am not saying there was - it could be regarded as a matter of ethics. But it could perhaps also be regarded as a failure to discharge a legal and professional responsibility.

21. As the allegation reveals, the boundary line between professionalism and ethics is a shadowy one. Professional codes of conduct prescribe pursuit of high standards of both professional conduct and ethical conduct without drawing a distinction between the two. And, for present purposes, I shall treat professionalism and ethics as one topic without differentiating between them. This is the approach taken by the ATO to the role and responsibilities of auditors.

What is an SMSF?

22. First, however, it is necessary to say something about an SMSF. SMSFs (also known as DIY funds) perform the same role as other funds, by investing contributions and making them available to members on retirement. The distinctive feature of an SMSF trust is that the members are the trustees – they control the investment of their contributions and the payment of the benefits.

23. Subject to some exceptions, a fund is an SMSF

- If it has a trust deed which complies with the Superannuation Industry (Supervision) Act 1993 (the SIS Act)
- It has 4 or less members
- Each member of the fund is a trustee
- No member of the fund is an employee of another member of the fund, unless they are related, and
- No trustee of the fund receives remuneration for his services.

24. A trust is a relationship between trustee and beneficiaries with respect to the trust property. The trustee holds the property for the benefit of the beneficiaries, subject to the terms of the trust. A trust is a relationship. It is not an entity, unlike a corporation.

25. As Arlene Macdonald points out in her instructive paper, an SMSF is a particular kind of trust where the trustee holds property and undertakes specific responsibilities for the long term benefit of the beneficiaries: to provide age pensions and retirement benefits. In doing so the trust serves a public purpose by encouraging people to look after themselves. Nonetheless it is a private not a public trust. An SMSF is an unusual trust in that all the members are required to be trustees.

26. SMSFs must meet the sole purpose test under the SIS Act. This test means that a SMSF must be maintained for the sole purpose of providing benefits to members upon their retirement, or to their dependants if a member dies before retirement. The consequence is that the members cannot enjoy a benefit from the investment before they retire, subject to some strict exceptions. Another consequence is that the fund cannot provide financial assistance or a benefit to a person or entity outside the fund. Yet Michael D'Ascenzo pointed out on Wednesday that a key contravention of the sole purpose test has been making loans to a member or relative.

The role and responsibility of trustees

27. It is convenient to deal with the trustees' responsibilities first. They do not exhibit in quite such a striking way the ethical standards which are clearly evident in the auditors' responsibilities. The primary responsibility of an SMSF trustee, as with any other trustee, is to comply with the provisions of the trust deed and with the relevant provisions of the law. In the case of the SMSF trustee, the relevant provisions of the law include the SIS Act and regulations and the Corporations Act as well as the provisions of the general law such as tax and trust law.

28. The SIS Act sets out rules which are deemed to be included in the trust deed of every regulated fund. According to the ATO, the rules require a trustee to

- act honestly in all matters
- exercise the same degree of care, skill and diligence as an ordinary prudent person
- act in the best interest of the fund members
- keep the money and assets of the fund separate from other money and assets (for example, your personal assets)
- retain control over the fund
- develop and implement an investment strategy
- not enter into contracts or behave in a way that hinders trustees from performing or exercising their functions or powers, and
- allow members access to certain information.

But s. 52 of the SIS Act sets out the trustee's covenants (duties) in more detail and it is important to have regard to the section. The SIS provisions on the trustee's covenants are

deemed to be incorporated in the trust deed (where it does not contain provisions to the effect of the covenants).

29. Failure to comply with the rules exposes the trustee and the fund to various consequences

- the fund may be deemed a non-complying fund and lose its concessions
- the trustee may be disqualified
- the trustee may be liable to prosecution and liable to substantial penalties
- the trustee may be liable to civil action by other members.

30. A complying fund that is made non-complying can suffer serious tax consequences. The fund's total assets (less member contributions for which no tax deduction has been claimed) are subject to tax at the highest marginal rate. In addition, any income in a year in which the fund is non-complying is taxed also at that rate.

31. Setting up a SMSF to gain improper early access is illegal. Trustees who knowingly allow improper access to benefits are liable to heavy fines and imprisonment. If a trustee is prosecuted and found guilty of either a civil and/or criminal offence under a civil penalty provision, the maximum penalties under Part 21 of the SIS Act are \$220,000 (civil proceedings) and/or 5 years imprisonment (criminal proceedings).

32. An important obligation of a trustee is to formulate an investment strategy and to implement it. Another is the obligation to keep proper records.

33. I should say something more about the sole purpose test. The sole purpose test is divided into core and ancillary purposes. A regulated fund must be maintained for at least one core purpose and one or more ancillary purposes. The core purposes relate to the provision of benefits for each member on or after certain events. Ancillary purposes relate to the provision of benefits in circumstances being termination of employment or cessation of employment due to ill health, death and other ancillary purposes approved in writing by the regulator. This last ancillary purpose allows a fund to provide benefits in situations of financial hardship and/or compassionate grounds. But note written approval of the regulator is required.

34. One way of determining whether there has been a contravention of the sole purpose test is to examine the character and purpose of the fund's investments. Hence the provision of a direct or indirect financial benefit to any party cannot be a factor in making investment decisions and arrangements.

35. If a fund conducts a business, that will be regarded as a possible indication that the sole purpose has been contravened. This is because the conduct of a business is thought to indicate that the fund is not administered for the sole purpose of providing benefits for the members and beneficiaries of the fund.

The role of the adviser