CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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Dear Ms Rowell

Prudential standards for superannuation

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body in Australia delivering authoritative accredited education and the most practical training and information in the field, CSA is focused on improving organisational performance and transparency.

Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act), with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies. We have drawn on their experience in the formulation of our submission on the matters canvassed in the discussion paper.

CSA welcomes the opportunity to comment on the prudential standards for superannuation discussion paper (the paper).

General comments

CSA welcomes the proposal to increase the regulatory ability of APRA to make prudential standards in relation to superannuation. This is a positive step forward in defining guidelines which will provide greater clarity to the superannuation industry and promote a greater understanding about the importance of appropriate superannuation governance at the individual and organisational level.

CSA is also cognisant that the superannuation industry has had a long and complex development, including previous attempts at change. While many of these attempts have addressed specific areas of concern, CSA notes that the ever-changing nature of the superannuation industry has had an impact upon service providers. It is prudent, therefore, to be wary of over-burdening service providers through constant changes to and redevelopment of this area of regulation.

Any review of the superannuation system needs to take account of the changes that have occurred since superannuation was introduced. When superannuation was initially introduced,

member representatives were elected as trustees to look after member interests, as members were locked in to the fund. Employers also had an interest in ensuring that funds were run properly as it was a reputation risk to them, given that the company had set up the fund itself. With choice now available in superannuation, members can transfer to another fund if they are unhappy, and many of what were originally employer funds have as many non-employee members as employee members. Therefore, there needs to be a regulatory and governance framework that provides for these different models, risks and accountabilities.

The proposed prudential standards for superannuation offer a chance to provide lasting and sustainable adjustment to the superannuation industry through promoting cultural change. While CSA does not suggest that any simplification of the regulation of the superannuation industry is straightforward or without consequences, it is important that the development of prudential standards provides a central reference point for all companies within the industry regardless of shape, size and complexity.

CSA, therefore, supports the development and introduction of prudential standards in achieving these outcomes. As a general principle, CSA notes that the issues raised in the discussion paper are best addressed by specifying good practice principles rather than legislative provisions. Implementing principles which promote accountability and transparency will lead to better organisational and cultural practices, and in turn will result in better governance procedures for many entities.

CSA also notes that on 6 December 2011 the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP, announced that he has referred the future of the annual general meeting (AGM) in Australia to the Corporations and Markets Advisory Committee (CAMAC). The terms of reference include consideration of how documents and meeting forms should change to meet the needs of shareholders in the future; the risks and opportunities presented by technological advancements; and the challenges posed to the structure of the AGM by globalisation.

CSA notes that Australian superannuation funds generally hold positions in hundreds of listed Australian companies and account for a large quantity of the shares that are traded on the Australian market. For example, the Australian Council of Super Investors notes on its website that its members currently represent more than AUD$300 billion in funds under management and 57 per cent of the Australian not-for-profit superannuation sector.

Superannuation trustees, through their fund managers, are required to assess agenda items with care and caution, and exercise their votes in a manner consistent with their fiduciary duties. However, many funds often do not have the ‘in-house’ capability or resources to conduct independent research about each agenda item for each company's ballot at the AGM. Even the best-resourced funds require quality, independent information gathered by proxy advisory services. Accessing quality, independent information in relation to a range of issues assists superannuation funds to discharge their voting responsibilities. Such information, which includes recommendations on voting on proposals to be put to shareholders, may have a material effect on voting results. While superannuation funds have an obligation to make their own decisions and vote accordingly, the recommendations put forward by proxy advisory services will be attended to by those who commissioned the research. In some instances, investors may be reluctant to vote against the recommendations of proxy advisory services.

At present, there is no mention in the current discussion paper of any minimum governance arrangements required to ensure that superannuation funds are taking due care and diligence with regard to their stewardship responsibilities to vote shares registered in their name on resolutions put to them as members of companies at general meetings.

CSA also notes that there have been questions raised in relation to the physical lodgement of proxies or direct votes, particularly where funds shares are held in the name of nominees or custodians. Providing assurance to the regulator and the market generally that the integrity of

the voting process has been maintained is critical to good governance. Such assurance can only be derived from superannuation funds having certainty that their instructions to vote their shares have been carried out properly.

Again, the current discussion paper makes no mention of the governance arrangements that superannuation funds should put in place to review their processes for the lodgement of proxies or direct votes, including the relationships with external custodians who are the registered owners of the shares. CSA is of the view that these issues could be addressed in the investment governance prudential standard and any accompanying non-binding prudential practice guide.

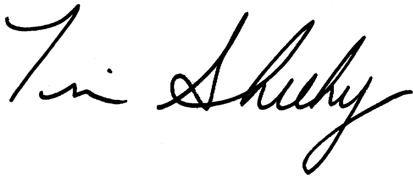
CSA therefore recommends that the prudential standards for superannuation include new sections in the investment governance prudential standard on the arrangements that APRA would expect to see in place in relation to superannuation funds exercising their stewardship responsibilities, including:

- assessing agenda items on general meetings of the companies in which they invest
- discharging their voting responsibilities
- providing assurance that the integrity of the voting process has been maintained.

In preparing this submission, CSA has drawn in particular on the expertise of its national policy committee, the Corporate and Legal Issues Committee, comprising governance professionals from a range of public listed and unlisted companies and with experience in trustee arrangements for superannuation. We look forward to receiving the draft prudential standards, draft reporting standards, forms and instructions in early 2012 for comment.

We would welcome the opportunity to discuss any of our views in greater detail.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

Chapter 3 — Governance

3.4.1: Independence of directors

CSA is cognisant that the term 'independence' is not one which is synonymous with the operation of superannuation boards in the conduct of their business. Part 9 of the *Superannuation Industry (Supervision) Act* 1993 (the SIS Act) provides that the representation of employers and members in relation to the management and control of standard employer-sponsored funds should be equal. This traditional set-up has created a tension in that a director may have a vested interest in representing a particular constituency, rather than the best interests of the superannuation fund overall.

The implementation of the concept of 'independence', therefore, is strongly supported. CSA is of the view that bringing more independent directors onto the boards of RSE licensees will assist in educating those boards as to their governing role and responsibilities to the fund as a whole. The conflicts of loyalty that can arise from members of a governing body incorrectly perceiving themselves as representing constituencies rather than the fund should, therefore, diminish.

CSA recognises that this shift will promote cultural change within the superannuation industry and supports the standard of not requiring a minimum number of independent directors on the board. Mandating a minimum number would create very real difficulties for the boards of superannuation funds in attracting suitably qualified and experienced directors in the first instance. CSA supports the introduction of 'an objective, principles-based concept of independence with broader application than the existing definition of 'independent director' in s 10 of the SIS Act'. This will instil the concept of 'independence' in the psyche of the RSE licensee's board and provide them with the encouragement to start acting, thinking and disclosing in a manner comparable to the boards of listed entities.

In promoting this cultural change, CSA agrees with the definition that a director may be considered independent even where they are or were a member of the RSE, provided that they meet the other criteria for independence. However, CSA notes that there is still some ambiguity in the paper with regards to the definition of an independent director who 'would be one who is not, and in recent years has not been' associated (in some role) with the employer sponsor. CSA believes that a definitive timeframe for the concept of 'recent years' should be implemented, so as to avoid ambiguity in the application of this term. In this instance, CSA believes that the terms of the draft *Prudential Standard SPS 510 Governance* should mirror the terms captured in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles and Recommendations) which provide a three-year time limit on independence with prior association.

CSA recommends that the draft *Prudential Standard SPS 510 Governance* include words which reflect the definition of independence in Box 2.1 of the ASX Corporate Governance Council's Principles and Recommendations, and would impose a minimum of a three-year time limit exclusion on a director being considered independent.

3.4.2: Independence of the chair

CSA notes that the concept of an independent chair of an RSE licensee's board is similarly a concept which has a limited historical context within the superannuation industry. However, the move to a greater number of independent directors should be matched by a move to an independent chair. Such a requirement removes uncertainty and will be highly influential in facilitating the desired cultural change. It is important, therefore, that the standards encourage the appointment of an independent chair in this first instance.

The ‘if not, why not’ regime of the ASX Corporate Governance Council’s Principles and Recommendations recognises that there is no typical type of entity and no singly identifiable model of corporate governance. If a listed company considers that particular Recommendations are not appropriate to its circumstances, it has the flexibility — under the ‘if not, why not’ approach — not to adopt them, as long as it clearly explains the reason(s) why.

CSA believes that this model could be applied to the appointment of an independent chair. CSA is of the view that the prudential standard should be reversed to require a RSE licensee board to appoint an independent chair or explain to APRA why a non-independent chair is in the best interests of the fund as a whole. For example, a superannuation fund may have a very experienced, non-independent chair and could have put in place a succession plan, as part of board renewal, to secure an equally experienced chair. However, one of the key criteria could be that the new chair be independent. This approach offers flexibility to reflect the variety of organisations within the industry, while also promoting cultural change.

CSA recommends that the *Prudential Standard SPS 510 Governance* be restated to require that an RSE licensee’s board appoint an independent director as chair, or explain to APRA why a non-independent chair is appropriate for the organisation.

3.4.3: Tenure and renewal policies

CSA supports the imposition of a board renewal policy for superannuation organisations but also agrees that it is inappropriate to specify a maximum tenure for directors.

Board renewal is critical to performance and directors should be conscious of the duration of each director’s tenure in succession planning, but this is best left to the board. This provides boards with the flexibility to decide the most appropriate selection criteria and processes for board appointments with review by APRA of those criteria and processes. What is appropriate for a larger fund may not be appropriate for a smaller fund. A robust board renewal process, as well as regular external board evaluation and a number of independent trustees on the board, ensure that the board is focused on reviewing whether the trustees are those appropriate to the needs of the superannuation fund. Longer periods of tenure by some board members can be useful to provide experience of economic cycles, which may be appropriate to the needs of funds, but this should be left to the board to determine.

3.4.4: Board assessment processes

CSA supports the view for implementing a requirement that boards maintain formal procedures for completing a regular objective assessment of performance, as such evaluations are essential to the evolution of professionalism on superannuation fund boards.

CSA also supports the requirement that the form of the annual assessment is not mandated, that is, the assessment could be internally or externally facilitated.

3.4.5: Use of board committees

CSA strongly supports the prudential requirement for an RSE Licensee’s board to have a board Audit Committee responsible for monitoring compliance with the board’s policies, prudential and statutory requirements, as well as for oversight of financial reporting, internal and external audits and the appointment of an external auditor.

While the requirement to have a board Audit Committee which is comprised of only non-executive directors of the RSE licensee is also supported, CSA notes that in the interim it may be impractical because of a lack of independent directors. CSA believes that an RSE licensee board which does not have any non-executive directors, or only one or two, should still be encouraged to retain a board Audit Committee. As superannuation funds transition to bringing

more independent, non-executive directors onto their boards, it will become feasible for all boards to have Audit Committees comprised entirely of non-executive, independent directors.

However, at present, there is a conflict between the standards not requiring a minimum number of independent directors, but instead requiring non-executive directors only on the Audit Committee. It is not possible to have an independent Audit Committee if there are no independent directors on the board.

CSA recommends that that the standard be restated to require that an RSE licensee's Audit Committee should be comprised of independent non-executive directors, or the board must explain to APRA why it does not meet the requirements of Audit Committee composition.

CSA believes that this approach accommodates the transition that RSE licensee boards will need to make in adopting the prudential standards, which will need to include increasing the number of non-executive and independent directors who participate in RSE licensee boards.

3.4.6: Remuneration

CSA supports the requirement that all RSE licensees establish and maintain a board Remuneration Committee with the same responsibilities as outlined in *Prudential Standard CPS 510*. CSA recognises that appropriate remuneration is a cornerstone of stewardship and accountability.

CSA is of the view that it is not the disclosure of the remuneration of trustees that is essential to transparency, although CSA strongly supports the remuneration provided to the trustees/directors and the CEO being made publicly available, ideally by posting it to the superannuation fund's website in a clearly marked governance section. CSA also suggests that reference to the appropriate section of the website could be made in the annual report.

Rather, CSA believes that the issues that go to the heart of transparency and accountability with respect to remuneration are:

- disclosing the remuneration provided to service providers, where conflicts of interest may arise, and
- disclosing the remuneration of the investment managers who make the investment decisions, and how these decisions are aligned with the risks to the organisation.

Any remuneration policy disclosed on the website should also address these matters.

Chapter 4 — Conflicts of interest

4.4.1: Conflicts management framework

CSA strongly supports the idea that an RSE licensee must adopt a holistic approach to managing potential and actual conflicts of interest. It is important that conflicts are managed to provide maximum benefit to the beneficiaries of the fund. As noted above, however, the traditional set-up for superannuation funds creates risks to an RSE licensee where a director may have a vested interest in representing a particular constituency, rather than the best interests of the superannuation fund overall.

CSA believes that the development and maintenance of a comprehensive system of internal controls and reporting, such as the development of a conflict of interest policy (4.4.2: Minimum requirements for a conflict of interest policy) is particularly important to helping an RSE licensee assess the real and perceived conflicts which might arise in the business. The implementation of the prudential standards will also likely provide new risks which RSE licensees will need to consider.

The key consideration, therefore, for an RSE licensee is to be able to manage risks with a flexible response. A conflict management framework has to be sufficiently flexible to be able to address changing conflict situations. For example, changes in personnel, suppliers and legislation/regulation mean that RSEs are not operating in a static but a dynamic environment. In such a dynamic situation, a principles-based framework is likely to be more effective than a detailed prescriptive framework.

This can be achieved by ensuring that there is an adequate conflict of interest policy compatible with the nature and size of the fund and the objectives of the beneficiaries. The disclosure of the policy must be clear and understandable having regard to the typical beneficiary.

4.4.3: Registers of duties and interests

CSA supports the principle that RSE licensees should be required to develop and maintain a register of all gifts, emoluments and benefits of a material nature which have been provided to directors and senior managers. The maintenance of a register of duties and interests provides a practical means of ensuring that there is transparency and accountability in the actions of those charged with managing the company. The presence of a register of duties and interests ensures integrity in the decision making process and develops a bona fide corporate culture.

However, building stakeholder confidence also requires the disclosure of the register of duties and interests to fund members and CSA notes that the concurrent disclosure of an RSE licensee's conflicts management policy, preferably on the organisation's website in a clearly marked governance section, would further provide a high level of transparency and accountability.

Chapter 5 — Fitness and propriety

5.4.2: Fit and proper policy

CSA supports the requirement for the RSE licensee to adopt a 'fit and proper' policy as part of *Prudential Standard SPS 520*. APRA guidance in this area currently exists through *Prudential Standard GPS 520*, and CSA notes that many RSE licensees will likely rely on compliance with this current standard in their operations. However, the requirement to disclose a 'fit and proper' policy is an important element of the risk management framework.

While the prudential standard currently requires that an RSE licensee undertake an annual assessment of the fitness and propriety of all responsible persons, CSA believes that an RSE licensee should be encouraged to undertake 'fit and proper' assessments as and when required, both prior to employment and when concerns are raised about a person's fitness and propriety in their position as a responsible person within the company.

Chapter 6 — Risk management

6.4.1: Risk management framework

Risk management forms an important cornerstone of superannuation governance. CSA, therefore, supports the proposed *Prudential Standard SPS 220* which requires the development of an adequate and appropriate framework for RSE licensees to effectively manage all material risks to which they are exposed.

CSA notes that these risks relate not only to the way in which the fund is managed, but also the way in which the fund invests. CSA reiterates that the risk management framework should

include a consideration of the remuneration of the investment managers and how remuneration practices for such managers are aligned with the risks to the organisation or the fund.

Chapter 8 — Investment governance

8.4.2: Formulating investment strategies

CSA supports draft *Prudential Standard SPS 530* which requires an RSE licensee to disclose the details relating to the setting and ongoing management of investment strategies. However, CSA also reiterates that this information should be captured in the superannuation fund's risk management strategy as detailed in *Chapter 6 – Risk Management*.

Chapter 9 — Operational risk financial requirement

9.6.2: Operational risk financial requirement can be met with fund reserves or trustee capital

CSA supports draft *Prudential Standard SPS 114* which allows an RSE licensee to maintain a general reserve to meet the operation risk financial requirement, where the RSE licensee considers that the reserves are held for the purpose of meeting operational risk losses.

However, CSA does not believe that the reserve should be built from trust capital which is garnered by charging a member fee. CSA does not support the charging of a fee to members to build trust capital as an appropriate way to either partially or wholly meet the operational risk financial requirement.

CSA would also recommend that where trust capital is built through charging a member fee to meet the operational risk financial requirement, that this should be disclosed to members of the superannuation fund.

Chapter 12 — Business continuity management

12.4.2: Business Continuity Plan (BCP)

Ensuring that an RSE licensee develops and maintains a BCP which looks at the company's needs on a 'whole of business' basis and identifies critical business functions and recovery arrangements is an important governance framework issue, which forms part of the risk management strategy and ensures that an RSE licensee is able to meet financial and service obligations to beneficiaries at all times.

CSA, however, is concerned about the requirement to make RSE licensees responsible for making an assessment of the adequacy of their material service provider's BCP testing processes and the adequacy of the recovery arrangements which are in place. CSA believes that this is an onerous obligation to place on trustees and one which might have unintended consequences for an RSE licensee.

The requirement, in itself, raises subjective questions about liability, and what constitutes 'adequacy' about the processes in place. However, once an assessment is made that a material service provider's BCP testing process or recovery arrangement is inadequate, it is then also incumbent on a trustee to know what the next step in managing the process should be. CSA notes that superannuation funds operate in a variety of ways and interact with service providers in a range of fields, and with potentially different levels of interaction and reliance. For example, an RSE licensee may outsource administrative functions to a company which is located

offshore. The implications in both process and transition, therefore, may be particularly onerous and uncertain in the event that the company's recovery plans are deemed to be inadequate.

While CSA supports the requirement to ensure that an RSE licensee has confidence that risks that are not under their immediate oversight are being appropriately mitigated, CSA believes that there needs to be greater clarity in the range of options and protections which are afforded to RSE licensees in the process of making an unfavourable assessment about the adequacy of a material service provider's BCP testing processes, or the adequacy of their recovery arrangements. In particular, CSA notes that it is important to ensure that the beneficiaries of the fund are not disadvantaged by any associated costs which might arise as a result of the decision to change service providers.

Chapter 13 — Insurance in superannuation

13.4.1: Requirement to develop and maintain an insurance strategy

CSA supports the APRA proposal to require that an RSE licensee develop, implement and maintain an insurance strategy that is appropriate to the membership of the RSE. However, CSA would also recommend that the RSE licensee be required to further publish the strategy and disclose the actions to their stakeholders.