CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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Mr Jeremy Cooper
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Dear Chairman and Commissioners

Review into the governance, efficiency, structure and operation of Australia's superannuation system: Phase one — governance

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

CSA members are all involved in corporate administration, governance and compliance with corporate obligations under the Corporations Act and the Australian Securities Exchange (ASX) Listing Rules, with substantial knowledge of a great variety of legislative frameworks. Our members have a thorough working knowledge of directors' and officers' duties and the *Corporations Act 2001* (Commonwealth) (the Corporations Act), and many are themselves officers as defined in the Corporations Act.

General comments

CSA welcomes the opportunity to comment on the governance of the Australian superannuation system. CSA notes that governance comprises four critical elements:

- transparency — being clear and unambiguous about the organisation's structure, operations and performance, both externally and internally, and maintaining a genuine dialogue with, and providing insight to, legitimate stakeholders
- accountability — ensuring that there is clarity of decision-making within the organisation, with processes in place to ensure that the right people have the right authority for the organisation to make effective and efficient decisions, with appropriate consequences delivered for failures to follow those processes
- stewardship — developing and maintaining an organisation-wide recognition that the organisation is managed for the benefit of its members, taking reasonable account of the interests of other legitimate stakeholders
- integrity — developing and maintaining a corporate culture committed to ethical behaviour and compliance with the law.

Given that governance is the method by which an organisation is run or governed, over and above its basic legal obligations, CSA believes, as a general principle, that many of the issues raised in the Paper are best dealt with as matters of good practice rather than by legislation or regulation. CSA is in favour of disclosure and transparency to members concerning governance arrangements along the lines of the ASX Corporate Governance Council's *Principles and Recommendations of Corporate Governance*, which provides one model for providing a framework for good practice against which reporting takes place. All listed companies must report against the Principles and Recommendations, and they provide a consistent structure for those stakeholders wishing to understand the governance of companies listed on the Australian Securities Exchange. Indeed, CSA notes that many of the governance requirements CSA highlights in this submission are already required by the Australian Prudential Regulation Authority (APRA), but not necessarily disclosed. CSA favours disclosure.

Notwithstanding our belief that many of the issues raised in the Paper are best dealt with as matters of good practice, CSA notes that there may be instances where a regulatory response is appropriate.

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 employer funds have as many non-employee members as employee members. Therefore there needs to be a regulatory and governance framework that provides for different models, different risks and different accountabilities.

We leave it to others to comment in detail on some of the issues raised in the consultation paper *Review into the governance, efficiency, structure and operation of Australia's superannuation system: Phase one — governance* (the Paper).

The issues we raise in this submission are governance and risk management issues that we believe should be considered by Super System Review.

5 General issues in APRA-regulated funds

5.1 General

5.1.2 Complexity

CSA notes that, due to the history of the superannuation system in Australia, there is complexity in some areas.

For example, historically, the trustee model arose when superannuation was introduced. Retail funds were introduced by institutions, which required a separate trustee company. In large corporate groups, the trustee normally outsources superannuation, usually to a number of related parties, such as a life office or other service provider. The life office in turn will appoint another part of the corporate group as the fund manager, with the trustee holding ultimate responsibility for control of the fund's assets and operating them solely for the benefit of its members and beneficiaries.

The life office has a board of directors, as does the trustee. The life office implements systems to ensure due diligence and proper process, as does the trustee. The result is duplication. There are two boards, with director fees paid to both. There is double checking of most processes. This does not occur in, say, industry funds, where there is the trustee and usually an externally appointed fund manager, but not another level in between.

Currently, in corporate groups, trustee agreements usually mandate that all aspects of the superannuation fund must be managed within the corporate group. A simplification of the structure in corporate groups in relation to superannuation would not diminish the level of trustee responsibility, or deplete the systems to ensure due diligence and proper process, but would reduce the duplication and over-regulation of this part of the industry.

CSA notes that another model that could be considered for corporate groups is the responsible entity model, in which the company both implements the systems to ensure due diligence and proper process and maintains full responsibility as a fiduciary to act in the best interests of the members. The introduction of the responsible entity concept in financial services, with its absolute regard for beneficiaries, removed the dual responsibility that can still exist in superannuation. The responsible entity could still outsource to different fund managers but ultimate responsibility would sit with the responsible entity, which would have the same level of responsibility as a trustee. This would occur without duplication of administration. The responsible entity model as applied to superannuation would also place the interests of superannuation members above the interests of shareholders.

CSA emphasises that it is not recommending favourable treatment for large corporations at the expense of industry funds. An argument can be put forward that the duplication of effort in corporate groups ensures that the trustee operates as a second house of review. It could be argued that a simplification of the regulation of superannuation within corporate groups would remove a level of review that ensures fiduciary duties are being met and introduce the perception of conflicts of interest. Counterbalancing this argument is the one that acknowledges the cost to members in introducing an additional layer of review in corporate groups which should not be discounted, given the trustees' duty to ensure that funds are managed in the best interests of members.

CSA does not suggest that any simplification of the regulation of superannuation in corporate groups is straightforward or without consequences. CSA points to this issue to illustrate that there is complexity in the system, due to the history of the development of superannuation and the trustee model.

5.1.6 Best practice

As noted in our general comments, CSA believes, as a general principle, that many of the issues raised in the Paper are best dealt with as matters of good practice rather than by legislation or regulation, given that governance is the method by which an organisation is run or governed, over and above its basic legal obligations.

CSA believes that standards of practice could be published against which superannuation funds are required to report. This would include the structure of the superannuation fund, and the following should be provided:

- the names of the directors on the trustee board and the manner of their appointment
- the name of the chief executive officer (CEO)
- any major outsourcing arrangements
- whether the superannuation fund has been granted a registrable superannuation entity licence
- the name of the auditor of the fund.

This information should be made publicly available, ideally by posting it to the superannuation fund's website in a clearly marked governance section.

However, as noted earlier, CSA is of the view that there are areas of governance where it is appropriate to introduce regulation. CSA notes that superannuation funds are far less transparent to members than are companies to shareholders.

CSA believes that the following disclosures should be mandatory for all APRA-regulated superannuation funds:

- the fund managers to whom the trustee outsources the management and investment of the superannuation fund
- the performance of the fund (including all investment options) in the past 12 months
- the remuneration provided to the trustees/directors and the CEO
- any adverse findings issued by APRA against the superannuation scheme
- the names of all trustees or directors where it is a corporate trustee and the period of office held by each trustee or director in office at the date of the annual report
- the name of the CEO/fund secretary
- the number of trustee or board meetings held during the year and the number attended by each trustee/director
- whether performance evaluations of the trustees, or board and its committees have taken place in the reporting period.

CSA notes that these disclosures could be made publicly available, ideally by posting it to the superannuation fund's website in a clearly marked governance section. Reference to the appropriate section of the website could be made in the annual report.

5.2 Trustees

5.2.1 Trustee duties

CSA believes there is merit in codifying the duties to act in good faith, avoid and/or disclose to the board real or apparent conflicts of interest and not seek personal profit. CSA believes that any such codification would largely act as an education tool rather than changing responsibilities, as those responsibilities already exist in trustee law. CSA therefore believes that codification of these duties would not be an imposition on the superannuation industry.

CSA notes that the model of a responsible entity regime under the *Corporations Act 2001* (Cwth) is one model that could be referred to.

CSA believes that any such codification of duties should contain explicit provisions enabling trustees to override deeds that require the trustee to invest or outsource within the corporate group, and that this would assist in reducing apparent or real conflicts of interest.

5.2.3 Trustee performance

CSA believes that it is a matter for the trustees of each superannuation fund to measure and report on their performance. CSA does not believe that a 'one-size-fits-all' approach to measurement of trustee performance, such as return on investment, will be of benefit to all members.

CSA notes that a trustee will appoint fund managers with different styles to accommodate the different investment choices that members will wish to make, as members will choose a different investment strategy according to the circumstances of their needs at the time. For example, younger members may wish to choose higher-risk, higher-growth investment strategies, while members closer to retirement may wish to make lower-risk, lower-growth investment strategies.

However, CSA believes that trustee boards should report to members on performance issues such as whether the trustee board met during the year and whether the trustee board monitored performance of all aspects of the fund.

5.2.5 Trustee independence

CSA does not believe that trustees need to be a member of a fund of which they are a trustee in order for their interests to be more fully aligned. Nor does CSA believe that trustees ought not have a personal interest in the fund. CSA notes that trustees have a core set of fiduciary duties designed to ensure that trustees act in the best interests of members. Moreover, CSA notes that very real practical difficulties can arise by imposing an obligation on trustees to have a personal interest in the fund of which they are a trustee. For example, a trustee could have a self-managed superannuation fund, and imposing an obligation to invest in the superannuation fund of which they are a trustee may impose an onerous financial obligation on that trustee.

5.2.6 Reliance on outsourcing and 5.2.7 Conflicts in outsourcing

CSA notes that the Paper questions whether funds have struck the right balance between internal and external expertise, given that nearly all funds outsource a large number of functions of the fund. CSA believes that it is not a matter of ensuring balance, but of acting in the best interests of the members, and that a focus on a balance between internal and external expertise clouds this fundamental obligation.

CSA notes that, from a governance perspective, the issue is to ensure that:

- there are proper processes in place in relation to outsourcing (APRA already requires this)
- those processes are documented
- outsourcing arrangements are on an arm's length basis
- service level agreements are entered into and actively monitored
- regular discussions are held between the superannuation fund and the outsource provider
- any related party issues are identified and processes are put in place to ensure that they do not detrimentally affect the fund
- trustees understand that they must not use their position or knowledge for personal gain.

5.2.8 Composition of boards and succession planning

CSA notes that the transparency of the process in relation to the appointment of trustees is the essential issue. The situation is not comparable to a company, where shareholder members exercise rights in relation to director election. Superannuation fund members do not have an interest in the superannuation fund as a company, but in the money they have entrusted to the fund to manage.

However, CSA recommends that the composition of the board and succession planning should be clearly documented and disclosed so that members are informed as to how trustees are appointed, including details of any body that has a right to appoint trustees/directors. These disclosures could be made publicly available, ideally by posting it to the superannuation fund's website in a clearly marked governance section. Reference to the appropriate section of the website could be made in the annual report.

CSA notes that it has been argued that trustee tenure should be limited to a certain period of years. There are arguments both for and against limits on trustee tenure. The argument for limiting tenure is that, unlike listed companies, where directors have to stand for re-election every three years, there is currently no check on tenure of trustees, with its concomitant check of whether the trustee continues to be the appropriate person for that fund's board. The argument against limited tenure is that 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 can be useful when trustees have had experience of economic cycles, which may be appropriate to the needs of funds. A further complication is that unions may have a right to nominate a certain number of trustees and they may have only a limited number of appropriately qualified individuals to nominate.

5.2.9 Stock lending

CSA believes that it should be left to trustees to decide if it is in the interests of fund members to lend stock owned by the fund.

However, CSA notes that there appears to be a gap in the application of the principle of disclosure. Disclosure underpins the Australian market. In order to ensure consistency in the application of the principles of disclosure by all market participants, CSA recommends that superannuation funds should disclose on their websites whether or not they permit stock lending by their investment managers/agents in relation to their investments, including details of any restrictions or limits on that lending.

CSA notes that, depending on the particulars of stock lending arrangements, superannuation funds and managed investment funds are potentially putting at risk the share price when they lend stock, and that investors should be in a position to make their investment decisions in full knowledge of a fund's policy on stock lending.

CSA acknowledges the importance of superannuation to the Australian economy and the retirement incomes of the Australian population. With superannuation a long-term investment, investors need certainty that stock lending arrangements do not unduly place at risk the value of their investments.

5.2.10 Consolidation

CSA opposes any move to oblige small funds to merge with larger funds in the pursuit of economies of scale.

CSA notes that it is for trustees to decide what the best interests of members may be and in doing so they will take into account a series of factors which may be more important than the costs of running the fund. For example, members might choose a particular fund on the basis of its investment policy, even if costs are higher.

Moreover, the consolidation of superannuation funds could create holdings so large that investment decisions cannot be changed without affecting the share market, which would be an unwelcome outcome.

5.3 Government and regulatory

5.3.1 Government policies

CSA believes that governments should not be involved in making choices for trustees as to where they should place investments or in any way be dictating investment decisions.

Should the government be keen for superannuation funds to invest in infrastructure, the government should put forward an investment proposal to attract superannuation fund investment, that is, they would need to make the case for the investment as a commercial proposition.

5.3.2 APRA regulation

CSA recommends that APRA's powers should not extend beyond prudential matters.

5.3.4 Related party transactions

CSA believes that, if the trustees cannot form a view that a commercial transaction is in the best interests of the members, the decision whether to proceed should not go to members, as it would under the corporations law regime.

The principles governing a related party transaction regime for superannuation funds should be based on the trustees forming a decision, subject to the following:

- If the transaction is material and non-commercial, it cannot proceed.
- If the transaction is not material and non-commercial, the trustees may form a view that it can proceed.
- Any person or trustee with a material interest should not participate in discussion or voting on the matter.
- If a quorum of disinterested trustees/directors is unable to be formed, the matter should not proceed.

Any such regime should be subject to carve-outs for matters such as D&O insurance and trustee/directors' fees, where all trustees have an interest in the matter. In such instances a mechanism is required to deal with the conflict of interest.

5.3.6 2007 PJC inquiry Recommendation 6

CSA does not support the PJC recommendation that the trustees of superannuation funds be required to publicly tender key service provision agreements. An open tender process could lead to unnecessary costs and unwieldy process dealing with multiple tenders, including ones from parties who are unlikely to be able to provide a satisfactory service. The trustees should get advice, if necessary, of the details of a small number of relevant parties to approach who could provide the service.

CSA notes that APRA does not currently require an open tender process.

5.4 Accountability to members

5.4.1 Accountability to members

CSA believes that superannuation funds are sufficiently accountable to members, with the proviso that CSA recommends that all APRA-regulated superannuation funds should provide the following disclosures:

- the fund managers to whom the trustee outsources the management and investment of the superannuation fund
- the performance of the fund (including all investment options) in the past 12 months
- remuneration provided to the trustees/directors and the CEO
- any adverse findings issued by APRA against the superannuation scheme
- the names of all trustees or directors where it is a corporate trustee and the period of office held by each trustee or director in office at the date of the annual report
- the name of the CEO/fund secretary
- the number of board meetings held during the year and the number attended by each trustee/director
- whether performance evaluations of the board, its committees and directors have taken place in the reporting period.

Of prime importance is the statement issued to members providing transparency on the investment of the member's money.

CSA notes that superannuation fund members do not have to make decisions about the fund of which they are a member, as do shareholder members of companies. Superannuation fund members do not have a vested interest in the company, but in the money that the trustees invest on their behalf. CSA therefore believes that there should be no obligation on superannuation funds, regardless of size, to host an annual general meeting (AGM) either physically or online.

CSA notes that, currently, superannuation fund members can take a dispute with a trustee to the Superannuation Complaints Tribunal. Superannuation fund members can also transfer their superannuation to another complying fund. Trustees must be aware that members have the right of choice and can transfer their money to another complying fund at any time, and that any failure of accountability could result in members exercising this right.

With regard to the suggestion that super fund members may need a body or association to represent them and advocate on their behalf on certain issues, CSA believes that it is up to members to decide if they wish to create such a body. If superannuation fund members are interested in creating such a body, it is a matter for individual members to do so, as is the case with the creation of any other member body or association.

5.4.2 Corporate governance of underlying investments

As noted earlier, CSA believes, as a general principle, that many of the issues raised in the Paper are best dealt with as matters of good practice rather than by legislation or regulation, given that governance is the method by which an organisation is run or governed, over and above its basic legal obligations.

CSA notes that members of superannuation funds will not hold a harmonised view of the exercise of votes on equity investments held by the fund, as their interests will differ. The costs associated with trying to determine the views of each member of a superannuation fund on each resolution put forward by each company would be substantial and impractical. The cost of canvassing decisions would be a cost to members, with no guarantee that any consensus would be reached.

CSA notes that there are already bodies involved in researching companies to assist superannuation funds with their investment decisions and that the trustees take ultimate responsibility for representing the interests of members in corporate board rooms.

However, CSA believes that superannuation funds should disclose to members their policy on voting.

5.4.3 Responsibility for investment

CSA does not believe that trustees should be guiding members on their individual investment decisions or providing financial advice.

Trustees offer the mechanics of an investment vehicle but it is a matter for the individual member, preferably with the assistance of a financial adviser, to make their own investment decision. Trustees should set out investment options and the risks attached to them, and this should be based on a profiling of their member base to determine what sort of investment options are most suitable for their members. Trustees may wish to seek external advice as to what options to offer members having regard to the member base.

CSA believes that trustees should disclose their reasons for offering certain investment options to members. However, CSA does not believe that trustees should be held responsible for not providing a particular investment option.

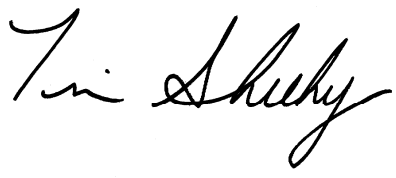
5.5 Operational

CSA has not provided any response to the issues raised in the Paper in this section, as they deal with operational rather than governance issues. CSA leaves it to others to respond to the issues raised.

Conclusion

In preparing this submission, CSA has drawn on the expertise of its Corporate and Legal Issues Committee (CLIC).

Yours sincerely



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