CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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Dear Neil

Draft prudential standards for superannuation

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals. It is the leading independent authority on best practice in board and organisational governance and risk management. Our accredited and internationally recognised education and training offerings are focused on giving governance and risk practitioners the skills they need to improve their organisations' performance and are 'first-choice' options for those intent on pursuing a C-suite career.

CSA has unrivalled depth and expertise as an independent influencer and commentator on governance and risk management thinking and behaviour in Australia. Our members are all involved in governance, corporate administration, legal practice and compliance with the *Corporations Act 2001* (the Act) with their primary responsibility being the development and implementation of governance frameworks in public listed and public unlisted companies, private companies, and not-for-profit organisations.

CSA welcomes the Australian Prudential Regulation Authority's (APRA's) Response to Submissions paper and the further opportunity to comment on the accompanying draft prudential standards. CSA draws upon the experience of our Members in formulating our response.

General comments

CSA strongly supports the introduction of prudential standards for superannuation funds. CSA is aware that the passing of the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (the Bill) through the House of Representatives on 23 May 2012 provided APRA with the requisite legal framework to introduce prudential standards to tackle issues of poor trustee governance. CSA notes that the prudential standards will cover topics common to other APRA-regulated industries as well as superannuation-specific topics.

However, CSA believes that the introduction of prudential standards will not be an easy task. CSA is 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. Any simplification of the regulation of superannuation

funds will not be straightforward or without consequences, and it is important that the development of prudential standards provides a central reference point for all organisations within the industry regardless of shape, size and complexity.

It is prudent, therefore, to ensure that the implementation of the prudential standards regime has an appropriate transition period. That is, it needs to allow for a reasonable time between the passage of the legislation and the start date to ensure that it achieves the changes in practice that the standards are intended to address.

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

However, with the advances in investment products and options, the development of investor knowledge, and the globalisation of financial markets and technology, the governance framework for superannuation funds now lags those of the companies in which they invest. CSA believes that this is a situation which the prudential standards seek to address.

With a vast number of Australians becoming indirect shareholders through the investment of their superannuation savings and contributions, the introduction of more transparency in the operation of superannuation funds is paramount to providing these indirect shareholders with the right information for them to make informed investment decisions. While we recognise that members now have the ability to transfer their superannuation to another fund if they are unhappy with the performance of the fund, CSA still believes that members are at a disadvantage with respect to the disjunction between the compulsory requirement to save for the future and the opacity of the superannuation industry in relation to its governance. CSA notes that shareholders in companies, aside from having the right to move their investment to another company, also have direct powers to remove directors if their current investment is not performing. This is not a right afforded to members of a superannuation fund.

Unfortunately, superannuation funds are far less transparent to members than companies are to shareholders. CSA has previously advocated for the superannuation disclosure regime to mirror the reporting requirements of listed entities under the Australian Securities Exchange (ASX) Corporate Governance Council's *Corporate Governance Principles and Recommendations* (the Principles and Recommendations). This framework is one which offers a model for good practice against which corporate reporting takes place. All listed companies must report against the Principles and Recommendations on an 'if not, why not' basis, and they provide a consistent structure for those stakeholders wishing to understand the governance of companies listed on the ASX. The Principles and Recommendations offer a flexible framework for the corporate governance of listed companies, irrespective of their size or industry, providing transparency and accountability to their investors, the wider market and the Australian community.

The flexibility of the Principles and Recommendations approach can provide a foundation for an approach to governance disclosures which will best serve the interests of members; however, the superannuation industry requires a model unique to its own circumstances. The structure of the superannuation industry is not conducive to a replication of the Principles and Recommendations, and it would not be advantageous to try and subject superannuation funds to their exact requirements. Instead, the prudential standards regime must allow superannuation funds the freedom to organise themselves and respond effectively to the needs of their members.

To this extent, CSA is pleased to see that the draft prudential standards generally embody a principles-based approach to corporate governance for superannuation funds. CSA notes that cultural change can only be achieved through a principles-based approach. The adoption of a prescriptive approach, as has been evidenced in other jurisdictions, tends to view governance requirements as a set of compliance obligations rather than an opportunity to engage with members on performance and conformance.

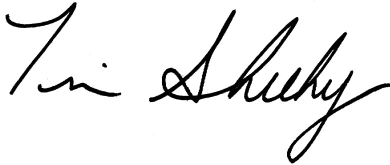
We also note the important role that APRA plays on behalf of superannuants in reviewing governance arrangements. Given that most members will not necessarily review governance disclosures or, if they do, may find moving their superannuation challenging for a multiplicity of reasons, members are relying on APRA to a large degree to test trustees' decisions and behaviours in relation to governance.

With this consideration in mind, CSA provides the following submission on the draft prudential standards concerning; governance, risk management, fitness and propriety, audit and related matters, and investment governance.

Although CSA does not wish to add further specific comment on the draft prudential standards concerning; conflicts of interest; outsourcing; business continuity management; operational risk financial requirement; defined benefit details; and insurance in superannuation, we would ask that these general comments be taken as applicable to these draft standards as well.

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

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

Prudential Standard — SPS 510—– Governance

CSA concurs with the responsibility that it is essential for an RSE licensee to have a sound governance framework and conduct its affairs with a high degree of integrity. CSA notes that ensuring the prudent operation of a competent board is paramount to achieving this aim, and that the historically opaque nature of the superannuation industry has often masked board functioning from members.

While CSA is supportive of the requirements specified in the prudential standard (SPS 510) on Governance, we believe that the standard could be extended to require a RSE licensee to develop a policy on nominee directors/trustees. CSA notes that such a policy will assist nominee directors to understand their legal obligations as well as the expectations of both their appointer and the fund to which they are appointed with respect to their conduct as a director.

A nominee director/trustee is often appointed to the board of a superannuation fund by, and to represent the interests of, an appointer. They are often appointed to control or influence, as well as monitor, the activities of the superannuation fund to which they are appointed. CSA notes that there have been many prominent examples where a director/trustee has been placed on the board of a superannuation fund by the government or a union, with the intention of influencing the operation of the fund.

Nominee directors/trustees, therefore, need to be aware of the strong possibility of a conflict between the interests of the superannuation fund to which they are appointed and the interests of their appointer. CSA acknowledges the draft prudential standard (SPS 521) on Conflicts of Interest, and notes paragraph 11 of SPS 521 which states that the board must have in place appointment procedures which require an incoming responsible person to disclosure all relevant duties and interests prior to their appointment. CSA is of the view that requiring a policy on nominee directors/trustees will assist to clarify that this particular conflict of interest needs to be addressed.

CSA is also of the view that a RSE licensee should be required to explain to APRA why it has a stand-alone audit committee. CSA believes that this involves justifying to APRA the circumstances of excluding risk from the function of the audit committee. While it is widely acknowledged that risk is often encapsulated within the audit committee, CSA notes that the role which risk plays in superannuation funds is different from that of other entities, in that aside from the risks associated with running a business, an RSE licensee is also responsible for the management of risks associated with the various investment options.

CSA notes the draft prudential standard (SPS 220) on Risk Management which requires an RSE licensee to have a designated risk management function responsible for assisting in the development, implementation and maintenance of the risk management framework, and specifically at paragraph 4 stating that ‘The Board of an RSE licensee... is ultimately responsible for the risk management framework’. Paragraph 41 of the governance standard states that the board audit committee may be responsible for providing a non-executive review of the effectiveness of the RSE licensee’s risk management framework, unless *there is another Board Committee which carries out this function*. CSA believes that the explicit reference to risk in an audit and risk committee would assist in ensuring that this function is not overlooked or otherwise unacknowledged, as would the right of APRA to seek an explanation of board oversight of risk management should a fund have a stand-alone audit committee.

Paragraph 17 requires that the board must have procedures for assessing, at least annually, the board’s performance relative to its objectives. CSA assumes that the requirement for board evaluation includes evaluation of board committees and individual directors/trustees, but notes that this is not explicit.

CSA recommends that paragraph 17 be amended to state:

> The Board must have procedures for assessing, at least annually, the Board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of the Board's committees and individual directors.

Paragraph 43 of the draft governance standard requires only that the board audit committee contain at least three members who are non-executive directors. CSA notes that a non-executive director may not be a member of management of the superannuation fund (the entity) but may be a member of management of the overarching group and therefore not independent.

In our previous submission, CSA noted that the standard should not require a minimum number of independent directors on the board or a board committee, as mandating a minimum number would create very real difficulties for the boards of superannuation funds in attracting suitable qualified and experience directors in the first instance.

CSA does, however, believe that instilling the concept of 'independence' in the psyche of RSE licensees is important and provides them with the encouragement to start acting, thinking and disclosing in a manner comparable to the boards of listed entities. The standard could encourage RSE licensees to appoint independent, non-executive directors to the audit committee.

Paragraph 59 limits a member of an audit firm or a director of an audit company from serving as a director of an RSE licensee for a period of two years since they served in that professional capacity. CSA notes that the Principles and Recommendations, in determining independence, ask the board to consider whether the director 'has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member'. CSA recommends that the prudential standard should match this three-year period, as there is a great deal of familiarity with the requirements of the Principles and Recommendations.

CSA is of the view that the greater the alignment between the Principles and Recommendations and the prudential standards, the less confusion there will be as to appropriate standards and therefore heightened compliance undertaken in full understanding of what compliance is seeking to achieve.

The requirement in paragraph 24 in relation to the board adjusting performance-based components of remuneration downwards does not stipulate a relevant time frame. The inclusion of a time basis for the adjustment would be useful. CSA also suggests that the standard could include a requirement for the RSE licensee to have a policy on clawback

Prudential Standard — SPS 220 — Risk Management

CSA is supportive of the draft prudential standard (SPS 220) on Risk Management. As noted above, CSA believes that risk management forms an integral component of the operation of superannuation fund, and that a RSE licensee should look to have an audit and risk committee review the organisation's compliance with the risk obligations of the board outlined in paragraph 4.

In line with this obligation, CSA also notes that greater clarity is required with respect to whether a RSE licensee is required to lodge its Risk Management Strategy (RMS) with APRA. CSA notes that paragraph 23 provides APRA with a mandate to require a RSE licensee to amend its RMS, yet there does not appear to be any requirement located elsewhere in the draft standard for the RMS to be lodged with APRA.

Paragraph 31 requires the lodging of a risk management declaration (which is outlined in Appendix A of the draft risk management standard); however, CSA notes that the risk management declaration states only that the RSE licensee show that it has an RMS and has complied with each measure and control described in the RMS. **CSA recommends** that the

wording of paragraph 23 could be amended to require an RSE licensee to lodge its RMS with APRA.

CSA also requests that greater clarity could be provided with respect to Part D of the Risk Management Declaration (Attachment A of SPS 220) which states that the risk management declaration must cover whether or not the risk management and internal control systems in place are operating effectively and are adequate having regard to the risks they are designed to control.

CSA believes that greater clarity can be provided to a RSE licensee by noting whether this requirement will be adequately satisfied by the review of an internal audit committee, or whether this process needs to be undertaken by an external auditor.

Prudential Standard — SPS 520 — Fit and Proper

CSA supports the broad concept underlying the fitness and propriety standard which requires that an RSE licensee is ultimately responsible for ensuring that the responsible persons of a RSE licensee are fit and proper for the role.

CSA notes that many RSE licensee boards cannot control the timing or appointment of all of their directors. As noted in our response to SPS 510, occasions arise within the superannuation industry where directors/trustees are appointed by other bodies outside of the control of the board. The mechanism for appointing directors/trustees can vary in these circumstances.

The requirement, therefore, that the fitness and propriety of a responsible person must be assessed prior to the initial appointment is not always feasible. It will be impossible for a RSE licensee to engage in a proactive assessment in some situations. Similarly, CSA notes that the requirement that a RSE licensee must take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a responsible person position for which they are not fit and proper may also be difficult where a RSE licensee is not responsible for the appointment mechanism of a director.

As the board does not always have control over the selection of candidates and the timing of director appointments, **CSA recommends** that the prudential standard needs to provide that

- the RSE licensee can assess the fitness and propriety of a responsible person as soon as is practicable after their appointment, where the appointing body is not the RSE licensee, and
- such an appointment can be rescinded if the appointed person is found not to be fit and proper.

Prudential Standard — SPS 310 — Audit and related matters

While CSA is supportive of the audit and related matters draft prudential standard (SPS 310), CSA is also cognisant that further clarity could be provided with respect to the operation of paragraph 15, namely the content of the auditor’s report.

CSA notes that SPS 220 makes no mention of the risks associated with outsourcing and business continuity management, which are respectively covered by SPS 231 and SPS 232. While CSA notes that the requirements of these standards includes an audit of the business continuity plan and the outsourcing arrangement, there is no clear incorporation of these aspects into the superannuation fund’s risk management plan, nor is there clarity around whether or not the audit would need to cover these aspects in relation to the risk management declaration required in SPS 220.

CSA is concerned that the uncertainty of these provisions may lead to inaccurate reporting by superannuation funds. At the least, a cross-reference to the other standards would assist in ensuring reporting is accurate.

Prudential Standard — SPS 530 — Investment Governance

While CSA recognises the importance of a RSE licensee identifying and approving the investment objectives of their investment options, CSA also believes that it is for the trustees of each superannuation fund to set the levels of risk, measure and report on their performance. CSA notes that a trustee will appoint fund managers with different styles to accommodate different investment strategies according 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.

The key aspect, therefore, of the prudential standard on investment governance is ensuring that there is clarity surrounding the range and options of investments which are available to members. CSA notes that paragraph 5(a) of the draft prudential standard (SPS 530) on Investment Governance requires that the board approve the investment objectives for each investment option offered in each RSE. This is also replicated at paragraph 10(a) with reference to the investment governance framework. CSA believes that this is a particularly granular requirement and it is unclear as to whether this requirement necessitates the examination of every investment product being offered or simply the various classes of investment which an RSE licensee may offer to members. CSA notes that a fund could have hundreds of investment options.

CSA notes that it would be more appropriate for an investment committee to be reviewing all investment options. A fund might need to respond quickly to a new product and such operational issues should not be dealt with at board level. **CSA recommends** that a fund have a proper approved process for determining investment objectives and that this responsibility should sit with the board.

Paragraph 23 of SPS 530 states that a RSE licensee must ensure that the calculation of measures monitoring the investment strategy must be undertaken by persons who are operationally independent from persons responsible for investment decision-making.

While CSA notes that this is an appropriate governance approach, it is also one which may unfairly impact on smaller superannuation funds which do not have the resources to segregate these duties. **CSA recommends** that the paragraph be amended to ensure that a process for reviewing the calculation of measures be implemented