CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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Dear Treasury

Exposure Draft: Superannuation Legislation Amendment (Further Measures) Bill 2012

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals in Australia. 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.

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 opportunity to comment on the Exposure Draft: Superannuation Legislation Amendment (Further Measures) Bill 2012 (the exposure draft) and draws upon the experience of our Members in formulating our response.

General comments

CSA is broadly supportive of the fourth tranche of legislation implementing the government's MySuper and governance changes, and is in strong accord with the intentions of the Stronger Super reform package, particularly in light of the public interest in ensuring a more transparent superannuation system for Australia's ageing population.

However, CSA is concerned that the current superannuation model does not provide the vast number of Australians who have become indirect shareholders of these entities with enough information about the governance of the funds in which they have indirectly become stakeholders through the investment of their superannuation savings and contributions. While the Stronger Super reforms have made some progress in governance, and CSA strongly applauds the government for taking these steps, it is important that superannuation governance, aside from

including a strong legislative regime, also recognises the unique circumstances of compulsory superannuation.

To this end, CSA supports the widely held view that 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, together with disclosure of reasons for deviating from the recommendations, can provide a foundation for an approach to governance disclosures which will best serve the interests of members. It will therefore be necessary to establish a set of guidelines which reflect the most common approaches to the very specific governance issues associated with the superannuation industry. However, given the wide diversity of circumstances facing superannuation funds and given different sized funds and member profiles, it is essential that funds have the flexibility to select a governance approach most suitable to their circumstances. A 'one-size-fits-all' approach is not an appropriate approach to corporate governance, or member investment needs, and CSA strongly believes that transparency as to decision-making is paramount to the reform process.

CSA, therefore, advocates that alongside the changes set out in the exposure draft, the following disclosures should also be mandatory for superannuation funds:

- the fund managers to whom the trustee outsources the management and investment of the superannuation fund
- any adverse findings issued by the Australian Prudential Regulation Authority (APRA) against the superannuation scheme or the parties to which it outsources
- 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 number of trustee or board meetings held during the year and the number attended by each trustee/director, and
- whether performance evaluations of the trustees, or board and its committees have taken place in the reporting period.

With these considerations in mind, CSA provides the following submission on the exposure draft and the proposed amendments to the *Superannuation Industry (Surveillance) Act 1993* (the SIS Act), and the *Corporations Act 2001*.

Service providers

CSA supports the proposed introduction of provisions to amend the SIS Act to override any requirement in a superannuation entity's governing rules which require the trustee to use a specified service provider, investment entity or financial product.

Superannuation entities' costs are a primary driver of the returns on investments for members of their funds. CSA supports the proposal to remove rules which potentially reinforce related party transactions within a superannuation entity's operations. Removing the potential for conflicts of interest to arise due to the superannuation entity's governing rules is important because it encourages superannuation entities to seek out the best value service providers for the fund instead. This, in turn, promotes better outcomes for members of the fund.

Infringement notices

While CSA supports the expansion of APRA's power to issue infringement notices for a broader range of breaches of the SIS Act, we also note that further clarification should be sought in relation to the phrasing of s 224A(2) of exposure draft which currently states:

> For the purposes of paragraph (1)(f) the amount to be stated in the notice for the alleged contravention of the provision must be equal to one-fifth of the maximum penalty that a court could impose on the person for that contravention.

CSA believes that the amount to be stated in the notice for the alleged contravention should be on a sliding scale up to one-fifth of the maximum penalty that a court could impose on the offender. CSA notes that not all breaches of the SIS Act will be of the same magnitude and the punishment, therefore, should not be a single amount but rather an amount proportionate to the severity of the alleged offence.

CSA recognises that the infringement notice regime in the corporate world, as administered by the Australian Securities and Investments Commission (ASIC), arose to remedy less serious breaches of a company's continuous disclosure obligations. ASIC's Regulatory Guide 73 states:[1]

> We have been given an additional remedy to address less serious breaches of the continuous disclosure obligations, which fills a gap in the current enforcement framework. Infringement notices are designed to provide a fast and effective remedy so that redress is proportionate and proximate in time to the alleged breach. The matter will be dealt with in a timely and efficient way, while still providing significant protection to the disclosing entity.

CSA similarly believes that the APRA infringement notice regime should also take into account proportionality issues in its consideration of the penalties to be imposed.

CSA recommends that the provisions of s 224A be amended to provide APRA with the discretion to vary the amount of the penalty issued with an infringement notice up to one-fifth of the maximum penalty which could have been imposed on a person for the contravention.

Actions for breaches of directors' duties

CSA is broadly supportive of the amendments proposed in Chapter 5 of the explanatory memorandum concerning the amendments to directors' duties. However, CSA is concerned that the standard which requires a person who has suffered loss due to a director's contravention of their duties under the SIS Act to seek leave from the court before bringing an action against the director is a blunt instrument which may inadvertently discriminate against persons who may be pursuing legitimate actions.

CSA believes that this kind of approach to protecting directors from liability for fault is problematic. Firstly, CSA notes that pursuing legal action is not a decision which a majority of litigants undertake lightly. Litigation is both expensive and requires a high level of advice before being commenced. Solicitors are also expected to advise their clients on the prospects of litigation outcomes before these actions are undertaken.

While CSA understands that this approach has been adopted to try and curb the pursuit of vexatious or frivolous legal actions, requiring a litigant to overcome a second hurdle in order to bring a legal action against a director could be unfairly prejudicial to those considering their options when confronted with potential director liability issues. CSA is particularly concerned that

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[1] Australian Securities & Investments Commission 'Regulatory Guide 73: Continuous disclosure obligations: infringement notices' June 2012, p4, from http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg73-published-5-June-2012.pdf/$file/rg73-published-5-June-2012.pdf

the extra legal costs associated with this imposition will impact upon low income earners and their legitimate rights, in some instances, to have a matter heard about the negligence or misconduct of a director, in a court of law.

The perceived creation of an extra hurdle to litigation also creates inconsistencies across directors' liability provisions generally. CSA notes that there is a currently a review occurring across all states and the Commonwealth headed by the Coalition of Australian Governments (COAG) to establish a nationally consistent and principled approach to the imposition of personal liability on directors and other corporate officers for corporate fault. While the review targets the operations of company law, rather than superannuation law, there is an overlap in the roles of directors who are also corporate trustees which is significant.

Trustee directors are those directors who serve as directors of a trustee company on the board of trustees of a superannuation entity. Their duties, therefore, are often split between the corporation for whom they work, and the beneficiaries of the superannuation entity. The Cooper Review in 2010 noted that trustee directors are subject to:

- the 'fit and proper' requirements for a Registered Superannuation Entity (RSE) licence
- s 52(8) of the SIS Act, which imposes the covenants set out in s 52(2) on the trustee-directors as though they were trustees personally, and
- those parts of the Corporations Act that apply to company directors.[2]

As a result, the Cooper Review noted that the obligations of trustee directors need to be made more explicit and the Review recommended the creation of a new distinct office of 'trustee-director' with all statutory duties (including those which would otherwise be in the Corporations Act) to be fully set out in the SIS Act.[3] Achieving this kind of consistency for directors of superannuation funds is important because as the Corporations and Markets Advisory Committee (CAMAC) noted in their 2006 report on personal liability for corporate fault, there are:[4]

> considerable disparities in the terms of personal liability provisions, resulting in undue complexity and less clarity about requirements for compliance

CSA believes, therefore, that it is important that consistency is achieved across director provisions, including within the superannuation industry. It is unclear from the explanatory memorandum as to whether or not there is a reason as to why directors of superannuation funds should be provided with the added protection of requiring an applicant to request the leave of the court. CSA is unaware of any visible abuses of the legal system through consistent vexatious and frivolous cases previously, which warrants the imposition of this amendment to the legislation.

CSA also notes and supports the extension of the defence in s 323 of the SIS Act to cover MySuper obligations. CSA believes that the defence which protects a director if their contravention was due to reasonable mistake, reasonable reliance on information supplied by another, or the contravention was due to the act of another, an accident or something outside the director's control, provided that due diligence and reasonable precautions can be shown, exhibits sufficient cover for directors in relation to MySuper obligations.

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[2] Super System Review 2010, *Review into the governance, efficiency, structure and operation of Australia's superannuation system: Final Report (the Cooper Review)*, Part 2, Chapter 2: Trustee governance, p45

[3] The Cooper Review, Part 1, Overview and Recommendations, Chapter 2: Trustee governance, p29

[4] Corporations and Markets Advisory Committee, *Personal liability for corporate fault: Final report*, September 2006, p1, from http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2006/$file/Personal_Liability_for_Corporate_Fault.pdf

Other measures and consequential amendments

CSA supports the amendment to the SIS Act to make ineffective the provisions within a superannuation entity's governing rules which prohibit a director or individual trustee from voting on a matter relating to the superannuation entity, except where a conflict of interest of duty exists.

CSA recognises, however, that this requirement relies heavily on a superannuation entity having in place a process for governing the conduct of responsible persons where there is a realistic possibility that the responsible person may have:

- a material or personal interest in a matter which would have significant impact on or is inconsistent with the best interests of beneficiaries
- a conflict or perceived conflict between the duties which he or she may owe to another entity of which he or she is a responsible person, and his or her duties as a responsible person of the superannuation entity.

Conflict of interest issues have been somewhat addressed by the APRA prudential standards which require that superannuation entities develop, implement and review a policy for managing conflicts of interest and that the policy be approved by the board. That policy should be one which identifies all relevant duties and relevant interests of the responsible persons of the superannuation entity, and where appropriate adopts the governance guidelines issued by industry and retail superannuation representatives such as the Australian Institute of Superannuation Trustees[5], and the Financial Services Council.[6] CSA believes, however, that more needs to be done to provide a coordinated and transparent governance framework for superannuation entities.

CSA notes, for example, that in addition to the existing APRA requirement to have a proper outsourcing process in place, in order to address conflicts of interest, superannuation funds should:

- ensure those processes should be documented
- ensure outsourcing arrangements are on an arm's length basis
- enter into service level agreements and actively monitor them
- hold regular discussions between the superannuation fund and the outsource provider
- identify any related party issues and put in place processes to ensure that they do not adversely affect the fund
- ensure that trustees understand that they must not use their position or knowledge for personal gain.

CSA reiterates that parts of the conflict of interest framework should also require disclosure. Without disclosure, CSA is concerned that these issues may not be sufficiently understood or addressed by stakeholders of the superannuation entity.

Conclusion

CSA is cognisant that the proposed amendments in the exposure draft address some of the concerns about governance issues which have previously been raised in association with superannuation law. However, it is clear that changing the culture and behaviours of superannuation entities will require the establishment of a disclosure regime which takes into account the complexities of the superannuation industry and the need for superannuation entities to take responsibility for governance of their superannuation funds.

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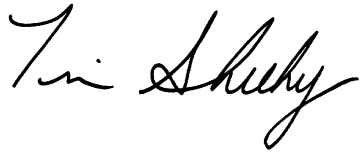
[5] Australian Institute of Superannuation Trustees & Industry Funds Forum, 'A Fund Governance Framework for Not-for-Profit Superannuation Funds: Inaugural edition', March 2011, p27

[6] Financial Service Council, 'FSC Standard No. [ ]: Superannuation Governance Policy' (Draft Standard), 22 August 2012

To achieve this, CSA strongly recommends that the governance of funds needs to be based on a high-level, principles-based approach which ensures that the disclosures made to members provide the right information for them to make informed investment decisions. The superannuation industry requires its own model, unique to its own circumstances, but CSA is of the view that a high-level, principles-based approach is more likely to provide members with the window into director and trustee decision making than a prescriptive approach. The principles-based approach has been shown to engender cultural change in corporations, with the governance of Australian listed companies among the best in the world.

CSA strongly believes that more can be done to ensure that the superannuation industry similarly achieves better governance outcomes and we would welcome the opportunity to discuss any of our views in greater detail.

Yours sincerely



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