



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

4 July 2013

Mr Neil Grummitt
General Manager, Policy Development
Policy, Research and Statistics
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Email: superannuation.policy@apra.gov.au

Dear Mr Grummitt

Draft prudential practice guides for superannuation

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.

Members of CSA are all involved in governance, corporate administration, legal practice and regulatory compliance and have a thorough working knowledge of applied governance, including matters such as board composition and renewal, director independence and risk management frameworks and are frequently charged with the responsibility of advising boards on these matters, both within companies and superannuation entities. The introduction of the prudential standards will therefore affect those CSA Members directly who are involved with providing advice and implementing the regulatory and governance frameworks in their organisations. Our Members' expertise is also useful in dealing with the applied aspects of the prudential standards.

CSA welcomes the opportunity to comment on the Australian Prudential Regulation Authority's (APRA's) draft prudential practice guides (the PPGs). CSA draws on the experience of our Members in formulating our response.

General comments

CSA notes that the review of the remaining draft PPGs completes APRA's review of superannuation-related guidance material to support the implementation of the new prudential framework for superannuation. The PPGs provide importance guidance to registrable superannuation entities (RSEs) looking to comply with the terms of the new standards.

However, CSA recognises that the changes to the superannuation industry extend beyond simply the introduction of the prudential standards. The superannuation industry has had a long and complex development, including a significant acceleration of reforms to the regulatory framework over the last 12 months, culminating in a situation where RSE licensees are required to comply with various legislative, product development, and prudential regulation. CSA believes, therefore, that the PPGs must provide a central reference point for all RSE licensees within the industry regardless of shape, size and complexity.

To this end, CSA notes that the PPGs must be written in a manner which affords RSE licensees with the flexibility to engage with the prudential standards and PPGs, and to make a decision on whether or not to adopt specific practices, find and implement alternatives where appropriate, and also document the reasons for particular decisions. An approach which provides this latitude will result in improved governance frameworks, as each RSE licensee must work through the issues in relation to the peculiarities of their organisation.

CSA does not support a rigid and direct approach which forces RSEs to conform, as this does not adequately address the specific policy or practice at issue. A prescriptive approach is also not advisable because it encourages organisations to ‘tick-the-box’ on governance and comply with standards without really engaging with them. Instead, CSA believes that the PPGs and prudential standards should foster a culture where RSE licensees genuinely seek to engage with areas of concern and address the policies, practices and behaviours which inform their internal cultural practices.

Promoting the disclosure of meaningful information

With a vast number of Australians becoming indirect shareholders through the investment of their superannuation savings and contributions, CSA believes that there needs to be more transparency in the operation of superannuation funds, as a way of ensuring that these indirect shareholders are provided with the right information upon which to make informed investment decisions.

The draft prudential practice guide on remuneration (SPG 511) provides an example of governance practice and policy, which if appropriately disclosed, enhances engagement, and also improves internal governance practices. CSA commends SPG 511 for adopting a sensible and measured approach to remuneration.

The difficulty in addressing remuneration governance guidance, however, lies not in the suggestions or recommendations made in respect of forming a board remuneration committee or detailing a remuneration policy, but instead, in ensuring that such measures actually achieve better governance results. For example, a board remuneration committee which is not comprised of independents will comply with SPG 511, but will also miss out on the feedback and objectivity that an independent trustee or director can provide on linking remuneration to performance and results.

While the board of directors and trustees shoulder the ultimate responsibility for the RSE’s remuneration practices, the lack of a reporting obligation on the board remuneration committee to report on policy and practice means that there is no countervailing pressure on them to objectively develop and implement appropriate remuneration policies and practices. CSA is cognisant that the *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012* requires RSE licensees to publish a product dashboard and other information, including the remuneration of directors and executive officers. However, we believe that any disclosure process should emphasise quality, not quantity. The disclosure of multiple facts does not of itself promote transparency.

Instead, there needs to be an emphasis on promoting the disclosure of meaningful information. The disclosure of the remuneration of directors and executive officers, while an improvement in governance practice, is also meaningless without reference to the policy and practice which influences the levels of remuneration being paid to directors and executive officers. As such, CSA believes that RSE licensees should also be encouraged to publish information on their board remuneration committees and RSE remuneration policy.

CSA is on the record as having previously advocated for there to be a disclosure regime for superannuation entities which mirrors 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.

CSA asserts that 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, we also strongly note that the superannuation industry requires a model unique to its own circumstances, and that the structure of the superannuation industry is not conducive to a replication of the Principles and Recommendations. It would not be advantageous to try and subject superannuation funds to their exact requirements, and the prudential standards regime must allow superannuation funds the freedom to organise themselves and respond effectively to the needs of their members.

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 for the following disclosures to 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, the period of office held by each trustee or director in office at the date of the annual report, and how many other trustee and director positions are held
- 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 and what the process of evaluation was.

CSA still believes that superannuation fund 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. Meaningful disclosures, therefore, ensure that RSE licensees remain somewhat accountable to superannuation fund members and allow them to decide on transferring their superannuation to another fund if they are unhappy with the performance of the fund.

Specific comments on draft prudential practice guides

CSA has in addition to the broader philosophies outlined above specific comments on some of the draft prudential practice guides.

Draft Prudential Practice Guide – SPG 160 Defined Benefit Matters

CSA believes that the PPGs should be highlighted to RSE licensees as an educative tool to assist superannuation entities with their governance and compliance obligations. CSA notes that taking this approach will be just as important as enforcing the prudential standards, and that where possible, different types of practices, and greater clarity on expectations should be built into the guidance for superannuation entities.

Practical guidance plays an important role in ensuring that good market practice and governance is highlighted for RSEs, to assist them with implementing the prudential standards in a manner relevant to their operations.

The draft prudential practice guide on defined benefit matters (SPG 160) provides an example where better market practice should be identified while ensuring that the guides are not prescriptive in their approach.

CSA notes that prudential standard on defined benefit matters aims to ensure that a satisfactory financial position is achieved and maintained, such that the value of assets is sufficient to cover vested benefits and liabilities as they fall due and payable. Paragraph 7 of SPG 160 highlights that a RSE licensee must provide an opinion as to whether there is a high degree of probability that a pension will be paid, with a probability of 70% touted as representing a high degree of probability. Further, paragraph 21 captures that the board may set a nil shortfall limit, i.e. a vested benefits index (VBI) of 100%.

CSA believes that beneficiaries of a defined benefit need to have a high level of confidence that benefit amounts will be paid, and that pensioners, who are often the recipients of defined benefits, are unlikely to know or understand that the defined benefit may depend on market performance. The probabilities identified above, therefore, do not match the expectations of the user group.

In particular, CSA notes that probability of 70% while high, is not consistent with market practice. **CSA recommends**, therefore, that higher percentages that align with market practice, be sought and inserted into SPG 160. CSA notes that this might include increasing the level of a high degree of probability to 80% or more. **CSA also recommends** that these levels be regularly reviewed to ensure that they remain consistent with market practice.

CSA believes that it is important that RSEs are able to provide APRA with appropriate assurance that they are able to meet the requirements of the prudential standards, so that, in turn, APRA, as the financial services regulator, can provide assurance to beneficiaries that the funds providing the defined benefits are prudently managing their members' funds.

Draft Prudential Practice Guide – SPG 221 Adequacy of Resources

CSA recognises that there is some tension between simplifying and cost-cutting for superannuation entities, and also ensuring that superannuation funds meet the requirements of the prudential standards.

CSA notes that the draft prudential practice guide on the adequacy of resources (SPG 221) provides an example where this tension may present a challenge for a RSE licensee. SPG 221 seeks assurances from RSE licensees that there are sufficient financial, human and technical resources available to be accountable for the prudent management of members' benefits.

However, CSA believes that this requirement may be difficult for superannuation funds that intend to provide MySuper funds only. MySuper funds are those that have a simple set of standard features and offer low cost accounts to superannuation holders. The objective of the MySuper regime is to minimise administrative costs to ensure that superannuation holders do not have unnecessary fees eating way at their savings.

Maintaining a low level of fees, however, may also require funds to carefully assess their human capital requirements. CSA notes that super funds looking to cut costs will likely look to reduce human resources before seeking efficiencies in other areas. A lower administrative fee puts pressure on a superannuation fund not to spend too much on human capital.

Draft Prudential Practice Guides – SPG 533 Valuation

CSA notes that the draft prudential practice guide on valuation (SPG 533) does not derive from a specific prudential standard, but rather draws its guidance from the *Superannuation (Industry*

Supervision) Act 1993 requirement for RSE licensees to consider whether reliable valuation information is available in relation to investments covered by an investment strategy.

While CSA is supportive of the use of models and independent valuations to assist with assessing investment strategy and performance, we also note that it is good governance for superannuation funds to turn over external auditors and actuaries on a regular basis. It is important that the assumptions made during assurance processes are challenged, and CSA notes that the regular rotation of auditors and actuaries can ensure that biases and mistakes are not perpetuated.

CSA notes, in relation to paragraph 9, for example, that although the board of a RSE licensee may provide appropriate delegations to a body such as a separate valuation or investment committee, and also utilise the assurances of auditors and actuaries; the board ultimately retains the responsibility for the investment strategy of the RSE licensee. It is important, therefore, that robust measures are in place to provide assurances that the strategy is appropriately formed.

CSA also believes that independence is key to a valuation or investment committee framework and **CSA recommends** that stricter conditions on independence be inserted into paragraph 10 of SPG 533, so that the paragraph reads.

Where such a body is established APRA expects that it would ordinarily be comprised of *objectively independent* persons who are *at commercial arms' length and* not directly involved in determining the valuation of the RSE's investments, and who also have sufficient skills and knowledge to provide meaningful oversight of valuation processes (emphasis added).

Conclusion

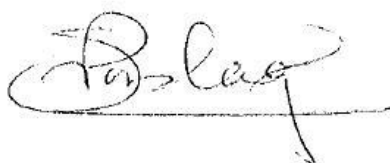
CSA recognises that there is a balance to be found for many RSE licensees in implementing the prudential standards framework, while simultaneously reviewing cost efficiency measures and implementing the MySuper reforms. CSA is cognisant that any proposal to establish a disclosure regime must be debated within this context.

However, CSA reiterates that superannuation funds need to provide more transparency in relation to the governance and operation of funds, which has been largely obscure when viewed in comparison to corporations. A disclosure regime for superannuation funds must take into account the complexity of the superannuation industry and the high incidence of conflicts of interest in the common support arrangements in the Australian superannuation models.

CSA reaffirms our strong support for the implementation of the prudential standards framework and the prudential practice guides.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Pordage', with a horizontal line underneath the name.

Simon Pordage
CHAIRMAN LEGISLATION REVIEW COMMITTEE