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30 March 2015

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: fsi@treasury.gov.au

Dear Treasury

Financial System Inquiry Final Report

Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our members are all involved in governance, corporate administration, risk management, with their primary responsibility being the development and implementation of governance and risk management frameworks in public listed and public unlisted companies, private companies, and not-for-profit organisations.

We welcome the opportunity to comment on the recommendations of the Financial System Inquiry Final Report (the Report).

We do not provide comment on all recommendations contained in the Report, but concentrate on those areas in which our members have expertise.

Our detailed comments are provided on the following pages.

Yours sincerely

Tim Sheehy
Chief Executive

Detailed comments on recommendations in the Report

Recommendation 12: Choice of fund

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

Recommendation 13: Governance of superannuation funds

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

Our comments on these recommendations are aimed at achieving the best governance outcome. We provide significant comment on Recommendation 13, but it has clear implications for Recommendation 12.

The Report concentrates purely on mandating a majority of independent directors on the board of corporate trustees public offer superannuation funds. However, board composition, definitions of independence and the management of conflicts of interest are components of a governance framework only. While important, they do not constitute a governance framework in its entirety. The key governance outcome from which questions of board composition and management of conflicts of interest flow is to aim for greater empowerment to members and greater accountability of directors[1] to members.

Governance Institute recommends that the key good governance outcome for superannuation funds is to provide for members of defined contribution schemes to appoint directors of trustees and for those directors to be accountable to members. This provides a governance framework in which other questions of governance structure can be assessed and decided.

Background to our recommendations

The superannuation industry has had a long and complex development. Any review of the superannuation system needs to take account of the changes that have occurred since compulsory superannuation was introduced in the 1990s.

At this time, employees usually had little or no choice in the superannuation fund of which they were a member. Nor did they usually have any say in the governance of the fund. The Superannuation Industry Supervision Act 1993 (Cth) (SIS Act) required that the boards of employer-sponsored funds consist of equal numbers of employer and member representatives. However, the employee representatives were typically, in the words of the Act, ‘nominated by a trade union, or other organisation, representing the interests of those members’. It was possibly not true in the 1990s and is even less true today that most members of employer-sponsored superannuation funds are members of trade unions. The members themselves should appoint and remove member representatives, not a trade union of which they are not a member and which does not represent their interests.

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[1] When this submission refers to ‘director’ we are referring to the person who serves as a director of a trustee company. The Super System Review (also known as the Cooper Review) report states that: ‘While it is possible under the SIS Act for a trustee to be a natural person, the vast majority of trustees of APRA-regulated funds are companies and it is the board of trustee-directors who are responsible for the trustee’s decisions and actions’.

Similarly, when compulsory superannuation was first introduced, most funds involved defined benefit schemes in which the member received a pre-determined pension on retirement (usually calculated by reference to their final salary) and to the extent the assets of the fund were insufficient to fund the pension, the employer was required to make good any shortfall. In the circumstances, employers had a legitimate interest in the performance and good governance of the fund and could oversee this through appointing directors to the trustee.

Today, most employees are members of accumulation schemes in which the employee, not the employer, bears the risk of under-performance or poor governance in the fund. Employers have no legitimate expectation to appoint directors to the trustees of accumulation funds. As defined benefit funds disappear, so should the role of employers in the governance of superannuation funds.

The governance of employer-sponsored superannuation funds (as opposed to retail or for-profit funds) should be directly in the hands of those with the greatest stake in the performance of the fund — the members.

In the case of retail or for-profit funds, the members are essentially acquiring a service for a fee and, if they are dissatisfied with that service or the performance or governance of the fund, they can transfer their funds to another service provider. Members do not expect a significant say in the governance of retail funds any more than they expect a significant say in the governance of, say, a bank. Rather they rely on strict prudential regulation by APRA to ensure that their interests are properly protected.

Industry and other employer-sponsored funds are a different case. They are not offering a service for a fee. They are not seeking to generate a profit for an owner. They exist solely for the benefit of, and to protect the interests of, their members. The principal say in the governance of these funds should be in the hands of the members of the fund, not trade unions or employers.

There are also self-managed superannuation funds (SMSFs), where the members are often trustees.

It is now around the quarter century mark since the introduction of the Superannuation Guarantee Charge (SGC), which requires all employers to provide a set, minimum level of superannuation each year for each employee. The result is that the Australian workforce diverts a significant and increasing amount of its wages or salary into limited options for long-term investment that, with limited exceptions, cannot be accessed until retirement. The policy rationale of this compulsory system is twofold (and interconnected): to ensure that the employee acquires a 'nest egg' of savings to fund, at least partially, their retirement; and to reduce the financial load on the state to contribute to that retirement.

There is therefore a significant public interest in ensuring that our superannuation system is well managed and governed in order to fulfil these objectives. The employee forced to make their superannuation contributions, and the state which has to pick up any outcome shortfall, both have an interest in ensuring that the governance framework of superannuation entities is sound.

What is the best governance outcome?

Governance encompasses the system by which an organisation is controlled and operates, and the mechanisms by which it, and its people, are held to account. It encompasses transparency, accountability, stewardship and integrity. As a matter of good governance, therefore, there is merit in providing members directly with the final say in the governance of their superannuation fund. An example of a similar governance arrangement outside of superannuation is the manner in which members of a corporation (shareholders) have the right to appoint directors of the board and hold those directors accountable to them for the performance of the corporation.

Equal representation was an important aspect of the governance structure established by the SIS Act in 1993. As the government noted at that time: ‘One of the most important ways in which members are able to participate in the management and protection of their retirement savings is through representation on the board of trustees’. However, as noted above, employee representation through third parties such as trade unions is no longer automatically applicable due to the introduction of choice in superannuation — members of a fund are no longer all represented by the union. And unless an employer has a defined benefits scheme, where it retains responsibility for performance, there is no longer a reason to ensure employer representation on the board of trustees either directly or through third parties such as employer associations.

Furthermore, the representation of members through third parties introduces conflicts of interest, as the directors may have competing loyalties between the members of the superannuation entity to which they owe a primary duty and the organisations which they represent. Such situations present a risk, real or perceived, that directors may make decisions based on these external influences, rather than the best interests of members.

Clearly, then, the best governance outcome would be to introduce a mechanism which allows members of the fund to appoint and remove directly the directors of the trustee and hold those directors accountable to members. That is, no one apart from members should have the decision-making power as to the appointment of directors. The special public purpose which superannuation plays also requires that directors be accountable as a matter of public policy. However, currently, this model does not generally exist.

Can governance practices from the corporate environment be applied in the superannuation system?

Governance Institute members are of the view that the governance arrangements applied in the corporate environment cannot be transposed in their entirety to the superannuation industry, but that there are elements of the governance framework in corporations that should be considered, modified and applied to superannuation entities.

We support the view set out in the Super System Review: Final Report that:

> The governance standards that apply to major listed entities are a reasonable starting point for the requirements that should apply to trustees and their trustee-directors, given the profound impact the latter have on the retirement incomes of members. This is particularly so in light of the growing influence that super funds have in advocating corporate governance practices for entities forming part of their investment portfolios that are not necessarily matched in their own practices. Turning the governance spotlight on trustees’ own operations is, in the Panel’s view, critical to the long-term sustainability of the superannuation system.

The Super System Review: Final Report also notes that:

> Research in corporate governance generally shows that boards should be of an appropriate size and that boards that are too large can become ineffective and inefficient. Further, the Panel has been made aware that some trustee-directors seem to be appointed for an unlimited term and that turnover on the board rarely happens, or only happens for some trustee-directors and not others. Again, research shows that succession planning and regular turnover on the board is important for good governance and new ideas.

We note that our recommendations are not intended to apply to:

- defined benefits schemes — our recommendations are intended to apply to defined contribution schemes, or
- SMSFs, which are currently supervised under a separate regulatory model.

Principles-based approach to governance

We strongly recommend using existing principles-based approaches to governance in place for listed entities and modifying them for application to superannuation entities as required rather than developing a new regulatory framework relating to the governance of superannuation entities.

The key principle underpinning the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (the Principles and Recommendations) is the 'if not, why not' model. This model is based on an understanding that governance cannot be a 'one-size-fits-all' approach and that if an entity considers a Recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it —- a flexibility tempered by the requirement to explain why. That is, this model provides for other approaches, subject to explanation.

Each ASX listed company is required under Listing Rule 4.10.3 to include in its annual report either a corporate governance statement that meets the requirements of that rule, or the URL of the page on its website where such a statement is located. The corporate governance statement must disclose the extent to which the company has followed the recommendations set by the ASX Corporate Governance Council during the reporting period.

Importantly, shareholders have the right to not elect or re-elect directors if they are unhappy with the explanation of independence provided in the corporate governance statement.

Definition of independence

While we note that the Principles and Recommendations need to be tailored to the superannuation environment, it is vital to understand that they do not 'define' independence. This is a common misunderstanding, based on:

- the fact that the Australian Prudential Regulation Authority (APRA) has taken the criteria for independence in the 2nd edition of the Principles and Recommendations and applied them as prescriptive criteria in the prudential standards applicable to financial institutions, and
- the tendency for those assessing governance practices and frameworks in listed entities (for example, proxy advisory firms and the governance teams of institutional investors) to take the view that listed entities must 'comply' with each Recommendation or be 'marked down' should they have practices other than those set out in the Principles and Recommendations.

In relation to independence, the Principles and Recommendations set out in Box 3.2 the 'factors relevant to assessing the independence of a director'. They do not comprise a definition, nor are they requirements. That is, the factors are examples of interests, positions, associations and relationships that may raise doubts about independence and require consideration, but they do not prescribe a loss of independence. It is for each board to assess if a director is independent, applying the lenses set out in Box 3.2 to the assessment process.

We are a founding member of the ASX Corporate Governance Council and have been involved in the development of the Council's Principles and Recommendations since the first edition (2003). We have therefore been closely involved in the development of the factors set out in Box 3.2. Governance Institute of Australia is a strong supporter of assessing independence as a lens for judging director capability but we note that it is not the only indicator of director suitability or capacity. While independence of judgment may be affected by the factors set out in

Box 3.2, it cannot be assumed that independence of judgment is lost if some of those factors are met.

Importantly, board composition policy should require companies to have a mix of directors on the board with different skills and diversity, and a robust board renewal plan should be in place. Board composition, as noted earlier, is only one element in a governance framework. Essential to a good governance framework is to ensure that there is director accountability to members, and the capacity for members to determine board composition in order to ensure that directors manage the fund in the best interests of members.

In relation to board composition, a central question in governance, which goes to the heart of accountability and stewardship, is: Who are you beholden to? This question is relevant when considering the conflicts of interest inherent in the current equal representation model for superannuation fund board composition.

Governance Institute is of the view that the approach to independence set out in the Principles and Recommendations is best suited to application to trustee directors of superannuation entities. That is, boards would need to examine interests, positions, associations and relationships that may raise doubts about independence and, should any of those indicators be met, explain to members why the board considers that the director retains independence.

With a board composition policy in place requiring a mix of directors on the board with different skills and diversity, and a robust board renewal plan also in place, importantly, therefore, members would have the right to appoint directors, which means they could choose not to elect or re-elect directors should they be unhappy with the explanation of independence concerning individual directors that the board provides.

If members are granted the right to elect — or not elect or re-elect directors — an independent director is essentially therefore one who has been elected by members, because members are of the view that the director is acting in their best interests.

To this end, **Governance Institute recommends** that the factors relevant to assessing the independence of a director found in the ASX Corporate Governance Council's Principles and Recommendations be adopted and applied, but that they would also need to be extended to include consideration of where a person is, or has been in the last three years:

- an employee or executive of an employer of members of the fund, or
- an employee or official of a trade union, or other organisation, representing the interests of members of the fund
- an employee of an employer association or body, representing the interests of the employer.

The appointment of employer representatives in the case of defined benefit funds would be permitted, but this would need to be reviewed regularly. For example, there are hybrid funds with defined benefit divisions which are a small proportion of the overall fund — that will become a still smaller proportion of the fund as previous members or their dependents cease to have a financial interest in the fund. Permitting employer representatives to be appointed in such cases would not therefore achieve good governance outcomes.

We refer Treasury to our *Good Governance Guide: Creating and disclosing a board skills matrix*, which assists boards and companies to identify the skills, knowledge, experience and capabilities desired of a board to enable it to meet both the current and future challenges of the entity. It can be found at http://www.governanceinstitute.com.au/media/762794/ggg_creating_disclosing_board_skills_matrix.pdf.

Consistency in governance arrangements
To ensure a reduction in the compliance burden, and enhanced understanding of any compliance obligations, it is preferable that there be as much consistency with existing relevant considerations as possible in assessing independence requirements that are put in place for superannuation funds.

Public listed companies have now had ten years to accustom themselves to the factors relevant to assessing independence provided in the Principles and Recommendations. Importantly, so have their institutional investors — the asset owners are superannuation funds. Superannuation funds therefore have a longstanding familiarity with the indicators of independence against which directors of public listed companies are held to account. Transposing the indicators of independence to the superannuation system is therefore not introducing new and unfamiliar definitions which will take time to understand.

The result is that the ASX Corporate Governance Council's factors relevant to assessing independence are extremely well known and understood. However, Governance Institute is not supportive of the prescriptive manner in which APRA has applied these factors, because it conflicts with the 'if not, why not' approach that has been so successful in changing governance practice and behaviour under the ASX Corporate Governance Council's guidelines.

We note that modifications to these factors would need to be introduced to ensure that they covered representative appointees (see our recommendations above). However, we strongly recommend that this be applied on an 'if not, why not' basis, as it is in the ASX Corporate Governance Council's Principles and Recommendations.[2]

Governance Institute recommends that:
- the ASX Corporate Governance Council's approach to independence be adopted and applied to superannuation entities, with the factors relevant to independence extended to cover representative directors, and this be applied on an 'if not, why not' basis, as it is in the ASX Corporate Governance Council's Principles and Recommendations
- consistency be introduced to the factors relevant to independence in the regulatory framework applicable to superannuation entities to reduce the regulatory burden.

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[2] There have been questions as to whether the SIS Act definition of independence should be utilised. In relation to the current definition in the SIS Act, which describes independence as someone who is not a member of a fund, an employee of an employer-sponsor or a representative of a trade union, we note that various issues arise that render this an unsuitable approach to assessing independence. That is, while directors may appear to be independent according to this definition, upon examination, it can be seen that they are likely not to be independent. The issues arising include:
- a director cannot be a member of the fund of which they are a director, but they will be a member of another fund, and may find they have a conflict of duty. By comparison, we note that directors of public listed companies are encouraged to hold shares in the company, as this is seen to align their interests with those of shareholders — directors holding shares in the company on whose board they sit is not seen to affect independence
- directors of a superannuation fund may hold multiple and competing positions on the boards of other funds, and will likely find they have a conflict of duty
- the composition of various board committees may not necessarily reflect independence — the board committees could be comprised of the directors of the trustee or they could be comprised of only one director and internal appointees, that is, executive management. Such a committee would not be independent.

Governance Institute does not support the SIS Act definition of independence, for the reasons set out above.

Majority of independent directors
The ASX Corporate Governance Council's Principles and Recommendations recommend a majority of independent directors on the board and that the chair be independent. Similarly, APRA applies to banking and insurance institutions not only the factors relevant to an assessment of independence found in the Principles and Recommendations as a prescriptive definition of independence but also the recommendation that the majority of directors be independent directors and the chair also be independent.

As stated in the influential Higgs Report[3] (that led to the revised UK corporate governance code and also influenced the first edition of the ASX Corporate Governance Council's Principles and Recommendations):

> As the non-executive director does not report to the chief executive and is not involved in the day-to-day running of the business, they can bring fresh perspective and contribute more objectively in supporting, as well as constructively challenging and monitoring, the management team. … Although they need to establish close relationships with the executives and be well-informed, all non-executive directors need to be independent of mind and willing and able to challenge, question and speak up. … At least a proportion of non-executive directors also need to be independent in a stricter sense. There is natural potential for conflict between the interests of executive management and shareholders in the case of director remuneration, or audit (where decisions on the financial results can have a direct impact on remuneration), or indeed in a range of other instances. Although there is a legal duty on all directors to act in the best interests of the company, it has long been recognised that in itself this is insufficient to give full assurance that these potential conflicts will not impair objective board decision-making.

Less than a majority of independent directors on a board may be seen to be tokenism. Any fewer than a majority would not have the capacity to influence decisions taken by management, given that the central premises of independence are that all directors should take decisions objectively in the interests of the organisation, and that conflicts of interest do not provide assurance that such objective decision-making is undertaken.

The representation of members through third parties introduces conflicts of interest, as the directors may have competing loyalties between the members of the superannuation entity to which they owe a primary duty and the organisations which they represent. Such situations present a risk, real or perceived, that directors may make decisions based on these external influences, rather than the best interests of members.

Governance Institute therefore recommends that a majority of independent directors is the appropriate proportion of independent directors for superannuation boards.

We note that the current two-thirds majority voting rule will need to be reviewed if a majority of directors are independent. No such majority voting rule applies to resolutions passed by company directors.

Independent chair
Separation of the role of chief executive and chair is seen as a central plank in a good governance framework, as it is avoids concentration of authority and power in one individual and differentiates leadership of the board from running of the business. To quote again from the Higgs Review, the following was the rationale for calling for the chairman of a public listed company to meet the independence test:

[3] Higgs, D, *Review of the role and effectiveness of non-executive directors*, January 2003

> The chairman needs to foster relationships of trust with both the executive and non-executive directors on the board, whilst at the same time maintaining support for, and partnership with, the chief executive. A degree of detachment from the executive can also be valuable in ensuring objective debate on strategy and other matters.

The same rationale applying to our recommendation of a majority of independent directors applies to the chair — a chair representing third parties introduces conflicts of interest, and presents a risk, real or perceived, that the chair may make decisions based on these external influences, rather than the best interests of members.

Governance Institute therefore also recommends that the chair of the board of trustee directors should be independent.

Given our earlier comments concerning the two primary models of superannuation funds, with the members of retail funds effectively being customers, it could be argued that there is less reason to call for a majority of independent directors to sit on the boards of trustees of commercial funds.

However, Governance Institute notes that the Financial Services Council (FSC) issued in March 2013 *FSC Standard No. 20 Superannuation Governance Policy*, which requires that the board of a member of FSC (retail funds) consist of a majority of independent directors and have an independent chair. The members of the FSC are bound to abide by its standards.

Given that retail funds have agreed to abide by a requirement to have a majority of independent directors and an independent chair, Governance Institute can see no reason why not-for-profit funds should not also be held to the same governance standards.

Alignment of liability and penalty regimes

There is a difference in the liability regimes attached to directors of a company and the trustees of a fund (directors have a fiduciary duty to act in the best interests of the company and trustees have a fiduciary duty to act in the best interests of members). We support the recommendation to align the director penalty regime with managed investment schemes but also recommend that liability regimes need to be explored to assess if they too need alignment.

Recommendation 15: Digital identity
Develop a national strategy for a federated-style model of trusted digital identities.

Governance Institute recognises that the advent of technology on a global scale has fundamentally altered the capacity to hold and access information held on a database and consequently is cognisant of the fact that there is a need to develop a national identity strategy to supply trusted digital identities to individuals and businesses. If implemented, we believe this would cut down on e-fraud, boost consumer confidence, and reduce compliance costs. The provision of these services by multiple providers should generate competition and innovation, while reducing costs for government and for the private sector as reliance on paper-based identity verification declines.

We note that the Report recommends the Productivity Commission hold an inquiry into the costs and benefits of increasing access to and improving the use of data, subject to privacy considerations. How an organisation collects, uses, discloses and otherwise handles personal information is subject to the *Privacy Act 1988* and an organisation must secure the private information it holds. Therefore, while supporting the national strategy in theory, Governance Institute would require a detailed proposal about the model before it could be considered properly.

Governance Institute has previously written to Treasury regarding the intersection of public policy concerning the collection and display of the personal information of company officeholders with a world changed by technology. Our concerns relate directly to the public display of personal information of officeholders available on the Australian Securities & Investments Commission (ASIC) register. This information allows the regulator to take action should the officeholder be in breach of their duties, which we support. We also strongly support the public policy that other persons too may need to accurately identify and locate individuals who are officeholders of companies in connection with the protection and enforcement of their personal rights and liabilities.

However, the advent of technology on a global scale has fundamentally altered the capacity to access any personal information held on an individual on a database. While we recognise that the information held on the ASIC register fulfils a different role than that held on other individuals on many other databases, the security of personal information remains relevant.

Concerns regarding risk of identity theft
Governance Institute is of the view that it is entirely appropriate that ASIC request and retain the personal details of all officeholders on a database subject to strict controls and restricted access.

However, identity theft is feasible if an individual intent on the crime has access to the given and family name, date of birth, residential address and place of birth of another individual. This is the very information that is required to be not only collected by the regulator but also publicly displayed for every officeholder in Australia.

We are of the view that the open publication of birthdates and birth places of officeholders serves no useful purpose other than for persons with criminal intent. In this world of increasingly faceless transactions, birthdates have unfortunately become by default the first form of identity check by banks, telecommunications companies and other institutions to ascertain that they are communicating with an authorised person. To make readily available the personal information of the business community's most influential officeholders is fraught with risk and a significant magnet for cyber-criminals.

The law requires a director to be 18 years of age. Date of birth is therefore essential to accurately identify if a person consenting to be a director meets the statutory requirement. A date of birth may also be useful in correctly identifying officeholders who share the same name, for example, John Smith. When date of birth is triangulated with place of birth, correct identification is assured.

However, while date of birth and place of birth are necessary to ensure correct identification by the regulator as to one particular officeholder being involved with one company rather than another, neither date of birth nor place of birth are necessary should an individual need to locate an officeholder to enforce rights and obligations if the triangulation has already been undertaken by the regulator. The address is required in this instance.

All officeholders on the ASIC public register are at a heightened risk of identity theft. We know that cyber crime is of concern to the corporate regulator — we refer to ASIC's Report 429 *Cyber resilience: Health Check* (REP 429) which aims to help its regulated population improve cyber resilience. While such reports are helpful, Governance Institute is of the view that our regulatory framework should not expose our directors and company secretaries to the risk of identity theft.

Concerns regarding personal safety

Our concern extends beyond identity theft to the issue of the personal security of senior officers. The companies with which they are involved may provide some level of security to high-profile CEOs and their families, but this is significantly undermined when their residential address is a matter of public record. Furthermore, as interest in the environmental and social impacts of companies continues to increase, a wide range of individuals can become interested in pursuing 'causes' by confronting directors and officers at their homes.

While it is possible for an individual to apply to have their residential address details suppressed on ASIC's public register because of safety concerns, the issue we are raising is one that touches every officeholder whose details are on the ASIC register.

Recommendations for reform that meet the public policy test

The issue therefore becomes one of ensuring that the public policy test is met while not putting officeholders at risk of identity theft or infringement of their personal safety.

Governance Institute is of the view that technology provides a solution to the accurate identification and location of officeholders should either the regulator seek to take action if the officeholder is in breach of their duties or any individual seek to locate an officeholder in connection with the protection and enforcement of their personal rights and liabilities.

We recommend that a unique ID be introduced by ASIC for each officeholder.

ASIC currently uses a code to suppress the address of a director if they have gone through the Electoral Commission process for a 'silent enrolment', so some thought has already been given to the use of technology to identify an officeholder.

The assignation of a unique identification code (ID) for each officeholder would:

- ensure that the regulator continued to hold all of the personal information required to correctly identify an officeholder and their connection to any particular company or companies (including legacy information)
- remove the risk of identity theft which is currently posed by the public display of personal information of officeholders, given that identity theft is facilitated greatly by the provision of date of birth, place of birth, full and former names and residential address.

One key business efficiency advantage of unique officeholder IDs that could be explored by ASIC, consistent with ASIC's deregulatory initiatives[4], is that this initiative should allow an officeholder to submit a single change of family name or change of address (residential or service address) to their ID data, which could then flow through to update all of the companies of which this person is or was an officeholder. It is highly inefficient for officeholders on multiple companies (especially entities with multiple subsidiaries) to have to lodge this same information over dozens, and sometimes hundreds of companies.

Any individual seeking to locate an officeholder to enforce rights and obligations could locate the officeholder they seek through the use of the officeholder ID. Any search would be conducted by using the name of the officeholder and company. It would be rare for two directors with the same name to serve on the board of one company, although it is possible. For example, currently there are two Mark Johnsons serving on the board of Westpac. However, given that the individual would be seeking to locate all officeholders of the one company, this would not be a concern.

Other parties are also interested in identifying and at times locating particular officeholders, as they seek to assess who has an interest in particular companies. Such third parties include the media, lawyers, banks and other creditors, liquidators and real estate firms. The use of an officeholder ID would assist this, as it would assist any individual seeking to locate an officeholder, as the ID held by the officeholder would reveal all of the companies with which they are involved. There are advantages to linking officeholders in this way, both for the regulator and those seeking to locate individuals in connection with the protection and enforcement of their personal rights and liabilities.

We also support the need for a mechanism to be publicly available in order to serve documents on officeholders. If an officeholder ID is used, there would need to be an obligation on each officeholder to provide a service address. However, the public generally does not need access to the residential address of officeholders.

Scoping study into the sale of the ASIC registry business

The proposed sale of ASIC's registry business highlights further the issues we have raised in this letter. Issues of data control, security and assurance will need to be considered in relation to the sensitive information currently held on the ASIC register.

There could be strong commercial interest in the personal information contained on the register. Information that is compelled by statute in order to ensure that the regulator can take action should an officeholder be in breach of their duties or to assist individuals in connection with the protection and enforcement of personal rights and liabilities has been provided for reasons of public policy, however, and has not been provided for commercial applications. It is important that any such information be collected for regulatory reasons, but it should not be made available publicly for the reasons set out above or for commercial applications, as this would be a fundamental breach of privacy and a misuse of the rationale for the public policy.

Governance Institute recommends that:

- ASIC retain the personal details of all officeholders
- ASIC issue each officeholder with a unique identification code
- the ASIC public register not display the date of birth, residential address and place of birth of officeholders, but the officeholder name, unique identification code and a service address.

[4] Refer ASIC Report 391, *ASIC's deregulatory initiatives*, May 2014 (Para 1) in which it is stated that ASIC's mandate is to 'strive to reduce business costs and administer the law effectively with a minimum of procedural requirements'.

Governance Institute recognises that amendments to the Corporations Act would be required to facilitate these reforms. Governance Institute also recognises that public consultation would need to be undertaken with stakeholders on any such reforms.

Recommendation 21: Strengthen product issuer and distributor accountability

Introduce a targeted and principles-based product design and distribution obligation.

Recommendation 22: Introduce product intervention power

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

Recommendation 23: Facilitate innovative disclosure

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

Corporate and financial services prospectuses and reporting are predicated on disclosure. 'Sunlight is said to be the best of disinfectants; electric light the most efficient policeman,' said Justice Louis Brandeis, US Supreme Court of Justice, in 1933. Justice Brandeis made this comment at a time when fraud and market manipulation led to market turmoil and the Great Depression. It was also made in the context of President Roosevelt's New Deal reform programs that eventually led to the passing of the Securities Act of 1933, the Securities Exchange Act of 1934, and the creation of the US Securities and Exchange Commission (SEC).

James M Landis, the architect of the US securities regulatory system said:

> My fundamental belief is that if the truth is told about these things, then it is up to the parties to decide whether they want to buy them or not. If they want to buy them, and speculate, well, let them go ahead and speculate. I've always felt that the furthest that practical administration could go was to call for a statement of the truth about any enterprise; but that some governmental agency should say you shouldn't buy stock in ABC company — I don't know who can decide a thing like that.

Disclosure is concerned with transparency, that is, letting the truth be available to all. Disclosure is seen as an effective tool for improving investor protection. Some of the responsibility for protecting the investor is shifted to investors themselves. This is the concept of informed self-interest — with good information, the perception of risk in the markets is reduced, as is the cost of capital.

Disclosure is also seen to encourage better management of enterprises. Disclosure is seen as addressing the two key problems in agency relationships, where moral hazard and conflicts of interest may arise, which are that:

- the principal is unable to verify (because it is difficult and/or expensive to do so) what the agent is actually doing. The two parties may have different interests and asymmetric information (the agent having more information), such that the principal cannot directly ensure that the agent is always acting in the principal's best interests
- the principal and agent may have different attitudes towards risk and because of different risk tolerances, they may each be inclined to take different actions.

Governance Institute is a strong supporter of disclosure. However, as noted in the Report, the current model in the Corporations Act focusing on disclosure and financial literacy is seen now as ineffective due to:

- behavioural biases
- consumer disengagement
- poor financial literacy.

The Report proposes a direct principles-based product obligation that addresses consumer needs by:

- stress testing

- consumer testing for understanding
- distribution
- periodic review post distribution.

Governance Institute agrees that emerging research in behavioural economics has provided important information about consumer decision-making in financial markets. It has shown that individuals often make errors when choosing and using financial products, and can suffer considerable losses as a result.

As set out in the 2013 paper from the UK regulator, *Applying behavioural economics at the Financial Conduct Authority*:

> **Why are there more behavioural problems in financial services?**
> For a number of reasons, consumer choice in retail financial products and services is particularly prone to errors:
>
> - **Many products are inherently complex for most people**. Financial products are abstract and intangible and often have many features and complex charging structures. This contrasts with many ordinary products where consumers can easily understand what they are getting and the product has a single, simple price. Faced with complexity, consumers can simplify decisions in ways that lead to errors, such as focusing only on headline rates.
> - **Many products involve trade-offs between the present and the future**. Often people make decisions against their long-term interests because of self-control problems, e.g. borrowing excessively using payday loans.
> - **Decisions may require assessing risk and uncertainty**. People are generally bad (even terrible) intuitive statisticians and are prone to making systematic errors in decisions involving uncertainty. So we often misjudge probabilities and make poor insurance or investment decisions.
> - **Decisions can be emotional**. Stress, anxiety, fear of losses and regret, rather than the costs and benefits of the choices, can drive decisions.
> - **Some products permit little learning from past mistakes**. Some financial decisions, such as choosing a retirement plan or mortgage, are made infrequently, with little learning from others, and with consequences revealed only after a long delay.

Governance Institute appreciates that the Report's recommendations concerning product intervention, product obligation and innovative disclosure have been considered within the context of behavioural economics. This accords with the thoughtful assessment that regulators have been undertaking on these topics. For example, the same paper from the Financial Conduct Authority (FCA) notes that as a regulator it is considering which interventions are available to protect consumers, and sets out four ways in which the FCA could solve behavioural problems:

> 1. **Provide information**. Require firms to provide information in a specific way or prohibit specific marketing materials or practices.
> 2. **Change the choice environment**. Adjust how choices are presented to consumers.
> 3. **Control product distribution**. Require products to be promoted or sold only through particular channels or only to certain types of clients.
> 4. **Control products.** Ban specific product features or whole products that appear designed to exploit, or require products to contain specific features.

However, Governance Institute would need to see more detailed proposed on product intervention and product obligation before we could comment on whether these are the most effective means of strengthening consumer outcomes, so that the detail of their impact can be considered, and an assessment made as to whether there may be any unintended consequences for consumers.

In the meantime, we note that there are areas where significant work and consultation has already been undertaken on facilitating innovative disclosure, and where removing regulatory impediments would achieve substantial outcomes sought by investors, regulators and companies.

Integrated reporting
Governance Institute is a strong supporter of the aims of integrated reporting. If the objectives of holistic, concise and meaningful reporting can be achieved, we are of the view that integrated reporting can demonstrate the stewardship capacities of an entity and how it creates and sustains value over time.

However, at present, there are significant regulatory impediments to achieving concise and holistic corporate reporting. Integrated reporting is not expected to reduce the 'clutter' at present. It will sit alongside existing annual reporting, although its long-term aim is to replace it.

One of the key barriers to effective investor engagement, particularly for retail investors, is information overload. While the typical annual report in 1985 was 20 pages, it is not unusual for the statutory annual reports of large listed companies to run to 300 pages or more of detailed financial and accounting disclosures which are largely impenetrable to the lay reader. Much of the information is also available elsewhere, including on company websites and the ASX announcement platform, and most of the annual report's information is backward-looking.

Furthermore, as identified by the Australian Financial Reporting Council's (FRC's) Task Force on *Managing Complexity in Financial Reporting* (2012), the current regulatory framework is not optimal as requirements by different bodies may be duplicative or inconsistent. There is also concern with the manner in which legislators and regulators respond to business and market developments by introducing further statutory requirements in financial and investor reporting.

Governance Institute believes that the aim of reporting should be to ensure that investors want to and can read the disclosures, and remain knowledgeable about the entity they invest in and remain engaged. However, given the reluctance of governments to review and reduce existing legislation, the challenges inherent in streamlining existing reporting obligations are considerable.

Governance Institute recommends that a holistic review be undertaken by Treasury of the different pieces of legislation and the Accounting Standards aimed at:

- deleting duplication
- reducing reporting requirements to ensure more simple, effective reporting.

Importantly, we recommend that any reform consider, review and report on the impact of any planned reform of the existing legislative and regulatory framework. Adding layer upon layer of further legislation or regulations on companies is not streamlining or clarifying reporting and disclosure.

Remuneration reporting
Governance Institute is of the view that there is an urgent need for an approach to legislative requirements concerning remuneration reporting that aims to simplify reporting, rather than adding layers of complexity, in order to provide investors with the clarity they seek.

Many companies have put considerable effort into drafting their remuneration reports as clearly and simply as possible over the past few years, but due to the interaction with the accounting standards the outcome has not been as effective as hoped. This is compounded by the addition of new pieces of legislation over time, which further complicate remuneration reporting, making it extremely difficult for investors to gain a clear picture of how remuneration decisions are made and applied in entities, or to gain transparency as to how much KMP are paid and how it is calculated.

The UK approach

Governance Institute has examined the UK approach to remuneration reporting with interest. The UK approach was aimed at the simplification of remuneration reporting, as it identified the issue of multiple figures being disclosed for each executive and how this added to the complexity and confusion, rather than providing clarity to shareholders.

In order to achieve accessibility and clarity, it was recognised by the UK Government that:

- existing legislation needed to be repealed in order to implement a new approach
- shareholders, in discussion with investor bodies, companies and remuneration experts, were better placed than public servants to develop an approach to remuneration reporting that met investor needs
- the new requirements developed by shareholders were to replace the existing requirements.

At the request of the UK Department of Business Innovation and Skills (BIS), the Financial Reporting Lab undertook a short-term project to obtain the views from the investment community on a new approach to remuneration reporting, with the objective that the output would be made available to help inform BIS's thinking in developing this disclosure requirement. The group that was formed consisted of shareholders, investor bodies, companies and remuneration experts. Importantly, the main driver was to develop remuneration reporting requirements that met investor needs.

The Financial Reporting Lab made a recommended to the UK Government — and the government adopted the recommendation. The overall project to arrive at a new approach to remuneration reporting was subject to nine months' detailed consultation. All parties had ample time to participate in the consultation process and provide their input and feedback.

Governance Institute does not recommend that Australia should simply import a concept from the UK, given that the UK concept had been designed to meet the needs of a particular jurisdiction. However, we note that:

- the consensus approach provided for frank and robust discussion of investor needs and how best to meet them
- the final approach to remuneration reporting was greeted with approval by shareholders, investor bodies, companies and remuneration experts
- there was agreement that the approach provided greater transparency to investors so that what people are paid is clear and easily understood.

On this basis, we are of the view that Australia should explore the UK approach. This could be effected through roundtables involving shareholders, investor bodies, companies, remuneration experts and bodies such as Governance Institute representing those involved in preparing disclosures, to tease out the issues and robustly test any suggested approaches to remuneration reporting. This could extend beyond remuneration reporting to corporate reporting in general.

Governance Institute recommends that Australia:

- develop a consensus approach between shareholders and companies to ensure any recommendations to the government on corporate reporting meet investor needs
- repeal existing legislation in order to implement the consensus approach
- introduce the new requirements to replace the existing requirements
- if appropriate, advocate for changes to the International Financial Reporting Standards.

Director liability
Financial information is backward-looking and static. Much of the reporting contemplated in the Integrated Reporting <IR> Framework is forward-looking, and therefore constantly changing. The International Integrated Reporting Council has noted that director liability in relation to forward-looking statements in reports is a much bigger issue in Australia than in other jurisdictions, given the lack of a safe harbour provision. Directors and officers are subject to extensive liability under various sections of the Corporations Act and under myriad other state and territory legislation. Australia also has an unregulated class action industry.

If directors are releasing prospective information, issues of personal liability arise. Directors are subject to statutory and common law duties which require them to act with reasonable care and diligence, in good faith in the best interests of the company and for a proper purpose. A defence may apply to decisions taken by directors in relation to breaches of care and diligence but it is not available, at least in Australia, where the process leading up to the decision is defective (such as where the decision is made on the basis of clearly inadequate information or it is not reasonable to rely on the advice of those providing the information). Providing forward-looking reporting means that the information provided could well be based on inadequate information, given that circumstances can change rapidly. This exposes directors to much higher risks of actions against them, including class actions, which are becoming increasingly prevalent and remain only lightly regulated.

At present, an adequate ‘safe harbour’ from liability for directors and executives for making forward-looking statements has not been adopted in Australia, although we note it has in other jurisdictions such as the UK. Governance Institute is advocating that such a ‘safe harbour’ be introduced in Australia, on the basis that the uptake of integrated reporting and the call for increasingly detailed forward-looking statements in ASIC’s Regulatory Guide 247 on the operating and financial review (OFR) will be hindered if this liability issue is not addressed.

We note that the call for a ‘safe harbour’ for forward-looking statements is not the same as the call for a revised business judgment rule, which is also currently being advocated by other bodies. Governance Institute does not support the proposals for a revised business judgment rule that are currently in circulation from the Australian Institute of Company Directors or Dr Robert Austin and has written separately to Treasury on this matter.

CHAPTER 5

Recommendation 27: Regulator accountability

Create a new Financial Regulator Assessment Board to advise government annually on how financial regulators have implemented their mandates.

Governance Institute is highly supportive of any assessment of our regulators that is bipartisan and outside the constraints of the political and electoral cycle. We also recognise that there are good examples of advisory boards that have delivered real value to the efficient and robust operation of corporations, financial markets and the economy as a whole.

In this regard, we point to the success of the Corporations & Markets Advisory Committee (CAMAC) which has been providing advice to successive Australian Governments since 1989 on issues that arise in corporations and financial markets law and practice. It is most usually called on after a corporate disaster reveals a deficiency in the current law or to assess how best to deal with new developments, such as technology, that mean that regulation needs to be introduced or amended.

Importantly, the advice provided by CAMAC was independent and the process of arriving at that advice was transparent. It was a research-based reform body, structured so as to facilitate the input of business, investment and advisory groups and legal experts. Its members were appointed on the basis of their knowledge and experience in business, financial markets, law, economics or accounting, with assistance provided by a Legal Committee, whose members have expertise in corporate law. Membership also ensured the representation of business, advisory and academic expertise from each state in reform discussions.

The advice provided by CAMAC was not subject to the constraints of the political and electoral cycle.

The members of CAMAC and the Legal Committee all served on a part-time basis, and were supported by three employees. The costs to maintain CAMAC were very low — $1 million per annum.

Regrettably, the Australian Securities and Investment Commission Amendment (Corporations and Markets Advisory Committee Abolition) Bill 2014 — which is a bill to abolish CAMAC — is currently before parliament. The body has been disbanded and the staff retired or redeployed. The Senate Standing Committee on Economics inquiry into the bill to abolish CAMAC has recommended that the bill pass.

While we recognise that advisory bodies can be effective, as illustrated by CAMAC, we do have concerns with the proposal to create a new Financial Regulator Assessment Board (FRAB) to provide government with regular formal advice on the overall performance of regulators to improve regulator accountability.

Independent assessment boards do have the potential to offer prudent independent advice as to how regulatory bodies are functioning. However, our members are of the view that a new FRAB could add another layer of potentially ineffective red tape.

Various questions arise that need to be considered:

- How effective can an oversight body be if it has no decision-making powers?
- Who chooses the FRAB members?
- How independent will they be? What will be the definition of independence? There are concerns as to the potential for partisan approaches to the selection of board members.

The Report notes that the main problem with the current arrangements is that the government lacks a regular mechanism to assess the overall performance of its financial regulators. However, Governance Institute is of the view that the current mechanisms, such as oversight by Parliamentary Joint Committees and Senate Committees, are not necessarily being utilised to their full extent and also that there may be other opportunities for such monitoring and assessment.

We also suggest that other mechanisms could be explored, such as inviting experts to sit on parliamentary committee inquiries, which may offer the same benefits of an advisory board at lower cost and less complex implementation.

Recommendation 28: Execution of mandate

Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

Governance Institute strongly supports bringing stability to the funding of ASIC by introducing a three-year rolling funding model based on periodic funding reviews. The question of the resourcing of ASIC is, undoubtedly, one of the key issues for the exercise of ASIC's functions, as is the fact that in the past few years, ASIC's responsibilities have expanded significantly.

Our members support the roles and responsibilities of ASIC in maintaining and facilitating the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and promoting the confident and informed participation of investors and consumers in the financial system. Stability of funding is essential to ASIC being able to perform its functions — annual funding makes the allocation and deployment of resources extremely difficult, particularly when investigation and enforcement objectives are being undertaken, as they can have long timeframes attached to them.

We also strongly support the recommendation that ASIC be exempt from the public sector bargaining framework and the *Public Service Act 1999* so that it can recruit and pay staff at market rates and on merit. We are of the view that ASIC should be free to employ the staff it thinks it needs and pay them accordingly, particularly in light of the need to employ people with extensive market and financial product knowledge and expertise.

While we recognise that all government agencies are being asked to be more productive and efficient — to do more with less — we have considerable concerns about ASIC's funding being cut while additional responsibilities are added to its remit.

Revenue raised by ASIC through its registry business goes into consolidated revenue, which in turn flows to the states. The model set up to facilitate the referral of powers may no longer be the most effective one. **Governance Institute recommends** that a permanent referral of powers be sought from the states, which would also provide for a full discussion concerning ASIC's funding, including revenue generated from its registry business.

Recommendation 29: Strengthening the Australian Securities and Investments Commission's funding and powers

Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

Governance Institute is of the view that much greater detail on an industry funding model would need to be released for public consultation, to allow for a proper assessment of it. We stress that this should be in the form of a consultation paper, rather than an exposure draft of legislation, in which the policy has already been formulated.

The Reports' recommendation of an industry-funding model is to ensure that those entities creating the greatest risk would be the ones carrying the greater amount of the funding, as they would require the greater allocation and deployment of ASIC's resources.

However, further work is required to assess if larger entities, due to their complexity (rather than their risk factor) would carry the greater burden of funding. It could be argued that there is significantly greater risk attached to smaller entities. Would the funding model therefore create barriers to entry, thereby conflicting with another recommendation of the Report to strengthen the focus on competition?

Another question that needs addressing is what the fairness criteria will be of an industry levy. We note that this will be challenging to formulate given the diversity of many of the sectors that ASIC regulates.

Questions of the potential for regulatory capture also need to be explored. Does an industry-funding model give rise to conflicts of interest? How would these be managed?

Recommendation 30: Strengthening the focus on competition in the financial system

Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of financial services and include consideration of competition in the Australian Securities and Investments Commission's mandate.

See our comments above that consideration would need to be given to whether an industry-funding model would have the potential to create barriers to entry.

Recommendation 31: Compliance costs and policy processes

Increase the time available for industry to implement complex regulatory change. Conduct post-implementation reviews of major regulatory changes more frequently.

Governance Institute realises that regulatory policy can, if properly structured and implemented, achieve desired public policy objectives in a cost-effective manner. This allows governments to achieve important economic, social and environmental objectives while also protecting public health and safety, and facilitating everyday economic transactions. Of course, for any regulation to be effective, it requires a high level of confidence among both business and the wider community that the need for any new regulation is real and any new proposals will be effective in meeting the objectives and addressing the targeted shortcomings in the operation of the market without imposing costs that outweigh their expected benefits.

Our members support the recommendation that the government and regulators should give industry participants increased time to begin implementing regulatory changes once they are finalised. We are often dismayed by how frequently the impact of implementation is underestimated by those drafting and passing the laws. Implementation frequently involves:

- changes to IT systems
- significant training of staff
- management time.

Governance Institute recommends that, if the regulatory reform is minor, then it is possible that business could probably implement it within 12 months. However, if it involves a major change, then realistically, at least two years should be allowed for business to adopt/implement the reform, particularly in terms of IT infrastructure and the need to recruit and train employees to assist in implementing the change.

Governance Institute also supports the recommendation that post-implementation reviews be conducted more frequently of major regulatory changes. Such reviews should consider:

- Did the regulatory reform achieve its policy objective?
- What were the main positive impacts of the reform?
- What were the main negative impacts of the reform?
- Have there been any unintended consequences attached to the reform?

Governance Institute recommends that review periods between three and five years after the implementation of regulation are appropriate, with an ability to address major negative impacts or unintended consequences at an earlier time.

Development of policy in relation to major regulatory reform

Governance Institute notes that it is not only the implementation of major regulatory changes that can create significant negative impacts on business and the community. Ensuring there is adequate time for consultation on proposed regulatory reform is also essential, as is ensuring there is a process for input at early stages of policy formulation. If reform consultations are effectively undertaken to 'rubber stamp' a particular regulatory approach which the government has already decided, this is viewed as a 'box-ticking' exercise, rather than one designed to seek input on policy formulation. We do not support the utilisation of consultation as a way of legitimising policy outcomes when insufficient consultation has occurred.

The Australian Government's *Best Practice Regulation Handbook* sets out the appropriate measures required for regulatory reform, and notes that proper consultation delivers better outcomes. Best practice consultation is:

- broad-based
- accessible
- not burdensome
- transparent
- consistent and flexible
- subject to evaluation and review
- not rushed
- a means rather than an end.

Best practice also means that a regulatory impact analysis should accompany any proposed reform which would include:

- sound analysis of perceived problems
- Informed decision-making which understands the implications of options for implementation, and
- transparency of information available to the government when regulatory decisions are made.

Our members stress that there should be adequate time to develop feedback on and review of proposed policies and note that best practice consultation is often not followed in this area. It is essential to allow respondents sufficient time to canvass views and generate discussion among stakeholders and potential respondents. When stakeholders do not have sufficient time to review the proposed reforms and consider their impact, it cannot be said that effective consultation is taking place.

For example, the period of consultation on exposure drafts of major regulatory reform over recent years has at times been less than one month and occasionally over the Christmas holiday period. The time frame for submissions of feedback on major pieces of legislation that will affect sectors for many years to come remains unacceptably short and poses particular difficulties. We are of the opinion that policy makers should consult in a genuine and timely way with affected businesses and the community, which is likely to lead to better outcomes and greater acceptance in the community, particularly among any stakeholders who may be adversely affected by the policy.

Governance Institute recommends that:

- the timeframes for consultation should allow stakeholders sufficient time to provide a considered response
- holiday periods and the end of the financial year should be avoided
- it is appropriate, as a guide, to provide between 6—12 weeks for effective consultation depending on the significance of the proposals, and
- where business and the community are potentially affected, they should be given sufficient time to consider the issue and respond, including allowing time for representative bodies to contact their members and consult with experts as required.

Governance Institute recommends that the regulatory impact assessment process could also be enhanced with:

- increased transparency in the decision-making processes concerning regulatory enactment or reform, including clarity on the structure, implementation and operation of regulations, and more importantly, the reasons for undertaking particular regulatory processes and their desired policy objectives
- stakeholder consultation in the form of roundtables and briefings prior to the release of discussion, options or consultation papers or exposure drafts to ensure that all issues are robustly and rigorously discussed, with those subject to proposed regulation and those seeking greater accountability through increased regulation being able to hear from and challenge each other and gain greater clarity as to the issues being addressed. Consultation should also canvass:
  - other approaches, such as whether a particular matter would be better dealt with through industry-led guidance and education, rather than turning to legislation in the first instance
  - whether stakeholders consider if the reforms are minor or machinery in nature or require Regulatory Impact Statements
- appropriate deliberation on the form of regulation to be enacted — for example, governance regulations need flexibility as the 'one-size-fits-all' approach of black letter law is often inappropriate when applied across diverse sectors and organisations
- more accountability of decision makers for regulatory decisions and for ensuring that regulatory reform is progressed in a manner that is timely and considerate to all stakeholders, and
- better leadership by Ministers and agencies which provides a clear outline of how the regulatory processes will be undertaken to achieve their stated policy aims.

Recommendation 37: Superannuation member engagement

Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.

Currently, if directors are releasing prospective information, issues of personal liability may arise. Directors and trustees of a superannuation entity have obligations under ss 52 and 52A of the *Superannuation Industry (Supervision) Act 1993* to ensure that their duties and powers are exercised in the best interest of the fund's beneficiaries. A defence may not be not available where the process leading up to a decision is defective (such as where the decision is made on the basis of clearly inadequate information or it is not reasonable to rely on the advice of those providing the information). Providing forward-looking information on retirement income projections means that the information provided could well be based on inadequate information, given that circumstances can change rapidly. Directors and trustees would require a safe harbour in order to be able to make such forward-looking statements.

Also, in relation to member engagement, we refer you to our comments on Recommendations 12 and 13. Member engagement in superannuation funds will be greatly enhanced if members are provided with a voice in appointing — and, if necessary, removing — directors. All funds are owned by individual members. It is a matter of good governance that those members should have a say in who represents them to act in their best interests.

Governance Institute strongly recommends that members of superannuation entities should be provided with the right to appoint directors, but that the decision-making (voting) should not be connected to a statutory meeting. An annual general meeting would not work in the superannuation sector. However, technology provides for direct voting by members, which can be utilised for director elections.

Recommendation 42: Managed investment scheme regulation

Support Government's review of the Corporations and Markets Advisory Committee's recommendations on managed investment schemes, giving priority to matters relating to:

- **Consumer detriment, including illiquid schemes and freezing of funds.**
- **Regulatory architecture impeding cross-border transactions and mutual recognition arrangements.**

Following a series of high-profile scheme collapses, and after a period of stakeholder consultation, CAMAC released a report into managed investment schemes (MISs) that identified problems in a range of areas, including arrangements for restructuring or winding up failed schemes. The CAMAC report also highlighted more fundamental concerns about schemes being used as vehicles for entrepreneurial activities rather than as passive investment vehicles. It found that most problems with the sector had arisen due to stress in 'common enterprise' schemes, where the MIS structure is favoured over the corporate structure for tax reasons. This in turn led to a number of difficulties in managing the financial distress of those schemes and consequent consumer detriment.

We recognise that the registered scheme, itself, does not have a legal identity, and that:

- the responsible entity (RE) becomes the entity responsible for the MIS, being a public company that holds an Australian financial services licence (AFSL)
- the licensing regime imposes certain obligations on REs, including that they have available adequate financial resources, and adequate risk management systems
- a registered MIS must have a scheme constitution, a compliance plan, and in certain circumstances, a compliance committee.

Our members note that the importance of risk management and good governance at the front end of operations for a MIS cannot be overemphasised. The delineation of roles, responsibilities and disclosures will ultimately benefit the operations of the MIS, particularly where a MIS is under financial stress.

From the outset, we have strongly supported CAMAC's key principle outlined in its second consultation paper, namely the alignment of the regulatory regime for MISs with that of companies, unless there are compelling reasons for treating registered schemes differently, given that the these two types of enterprise often operate in the same markets and perform similar functions.

Governance Institute supports a regulatory architecture with mutual recognition arrangements registering all wholesale MISs. Wholesale MISs that do not accept investment from retail schemes may be provided with exemptions to ensure that they are not unreasonably burdened with additional requirements; however, those wholesale schemes that accept investment from retail schemes should be required to ensure that they have in place appropriate governance, transparency and accountability frameworks.

Governance Institute supports a position that the regulation of MISs should mirror the requirements for companies, particularly where there is no good reason for a different regime to exist. We believe that this should be the base level of requirement for the regulation of MISs.

However, there are some areas where consideration should be given to having a higher level of regulation applied, where appropriate. For example, we note that retail MISs may resemble pooled schemes of retail investors regulated by APRA. Further, there may be no public policy reason for having the oversight of retail investors' money being managed differently in each of these areas, when concerns about the confidence and trust about retail investment remain.

Governance Institute recommends, therefore, that an APRA-style regime be instituted for the regulation of schemes. In this regard, we recognise the high level of interrogation that APRA brings to the oversight of retail investment, through the imposition of a prudential regulatory framework which we believe to be appropriate for the regulation of money invested in schemes by retail investors.