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Manager
Superannuation Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia
GPO Box 2820
Melbourne VIC 3001
Australia
Phone 1300 737 373
Outside Aust +613 9606 9677
Website cpaaustralia.com.au

By email: superannuationconsultation@treasury.gov.au

Dear Sir/Madam

Discussion paper: better regulation and governance, enhanced transparency and improved competition in superannuation

CPA Australia represents the diverse interests of more than 150,000 members in 121 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We welcome the opportunity to provide input into the above-mentioned inquiry. We make this submission on behalf of our members and in the broader public interest.

This submission has been prepared with the assistance of CPA Australia's Retirement Savings Centre of Excellence (CoE). The Retirement Savings CoE is a member based committee that includes leading experts from Australia's superannuation industry. Our superannuation experts work across major components of the superannuation industry ranging from some of the largest industry, corporate and retail funds through to SMSFs.

Trustees of APRA-regulated superannuation funds are entrusted with safeguarding and maximising the superannuation savings of millions of Australians. CPA Australia strongly supports the need for good corporate governance within superannuation fund boards and transparency of both funds' governance and investments. However, additional regulation should only be introduced if it provides an identifiable benefit to members, is in their best interest, and can be implemented cost effectively. We do not support regulation for regulation's sake.

In response to the main areas of the Discussion Paper, CPA Australia:

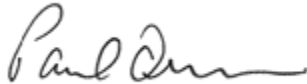
- Supports the intention of the Government to more closely align the governance structures in the superannuation system with corporate governance principles. However, given the unique characteristics of the superannuation industry and its participants we believe an overarching principles-based governance framework is required specifically for superannuation funds, from which threshold principles of good governance would then be articulated. Trustee director independence is only one aspect that may contribute to good governance and in itself will not necessarily achieve good governance.

- Supports the Government's commitment to improving the quality of information available to super fund members and employers. Superannuation fund transparency should provide fund members with relevant and useful information about their retirement savings including information on investment performance and details of portfolio holdings, with an ability to drill down to a level that provides meaningful information on how member funds are invested, and how well they are performing. However, it does have to be cost-effective and add value.
- Believes for the superannuation market to be truly competitive, employers should be able to nominate their default fund from all available MySuper funds. The nomination of default funds should be removed from modern awards.

Our general comments on the Discussion Paper and our responses to specific focus questions are provided in the Appendix.

If you have any questions regarding this submission, please do not hesitate to contact Michael Davison, senior policy adviser - superannuation on 02 6267 8552 or michael.davison@cpaaustralia.com.au.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Paul Drum', with a stylized, cursive script.

Paul Drum FCPA
Head of Policy

Phone: +61 3 9606 9701
E-mail: paul.drum@cpaaustralia.com.au

APPENDIX

GENERAL COMMENTS ON THE DISCUSSION PAPER

Part 1: A better approach to regulation

Superannuation funds and the financial services industry have been subjected to considerable regulatory reform in recent years and are still implementing changes due to Stronger Super, the implementation of MySuper and SuperStream, and APRA prudential standards. Any further reforms need sufficient lead time to allow superannuation funds to incorporate the recent changes and modify or establish the systems and procedures necessary to accommodate the new reforms.

Recommendation:

In respect of the proposed disclosure reforms, CPA Australia recommends a commencement date of 1 January 2015 at the earliest, to allow sufficient time for superannuation funds to establish systems and procedures to capture and present the information required.

Part 2: Better governance

Part 2 of the Discussion Paper in discussing the *Superannuation Governance Framework* commences with the following setting of context:

“Superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) are structured around **trustee arrangements** – there is a separation between members and trustees, with trustees managing funds **on behalf of members**. Typically in the current governance framework for APRA-regulated superannuation funds a **corporate trustee**, comprising a number of individual directors, controls the fund’s assets and operates it for the benefit of its members and beneficiaries.

Strong governance arrangements are needed to ensure fund members’ interests are paramount in the minds of trustees. The **trustee (and its directors) has fiduciary obligations to members and beneficiaries**, which require taking ultimate responsibility for the fund and an obligation to manage the assets with competence, diligence, prudence and honesty.” (Emphasis added)

The above passage is repeated here to emphasise particular characteristics of superannuation which distinguish it from commercial ventures undertaken through limited liability companies.

These distinctions are significant in that the Discussion Paper, whilst recognising the paramount objectives and structure of superannuation funds, draws heavily on governance models intended for, or drawn from, limited liability company arrangements. There is thus some risk in the proposals of creating a framework for the superannuation industry which obscures, or at worst undermines, good governance principles. These distinctions are briefly elaborated on:

- The overarching structure of superannuation is drawn from trust law, whereas corporate law and governance are predominantly based on contract law and tort of negligence.

- Superannuation funds give a clear and direct recognition to the benefit and beneficial interests (rights) of members (beneficiaries). In contrast, the rights of shareholders are determined primarily by the corporate constitution which is construed as a contract. What primacy there is for shareholders is achieved through the medium of the corporation.
- The director of a limited liability corporation has a fiduciary responsibility towards the company (a fiduciary relationship between director and shareholder is recognised in only very limited and specific circumstances: typically of reliance and dependence).

CPA Australia believes these distinctions should be more prominent in determining suitable superannuation governance frameworks than is apparent in the Discussion Paper's *Focus Questions* and associated explanations.

In particular, we believe there is undue focus on independent trustees in the Discussion Paper when there is no evidence of shortcomings in this area or evidence of a compelling benefit to superannuation fund members. Independence is only one aspect of good governance and in itself will not necessarily drive good governance outcomes.

Instead of an overly prescriptive approach, CPA Australia suggests a different approach in which an overarching governance framework is described addressing the characteristics of the industry and its participants, from which threshold principles of good governance could be articulated. This should provide a more sound basis for the operationalisation of good governance within corporate trustee entities. The approaches canvassed in the Discussion Paper present some risk of distracting attention away from critical attributes of fiduciary duty and beneficiary interest which are essential to superannuation.

CPA Australia believes an overarching governance framework should adopt a principal focus on duties, from which other elements of a framework would stem. These other elements would then span issues such as disclosure and board structure. It would be far more preferable to look at the essence of the objectives of superannuation entities and how this determines relationships, objectives and duties. Such a framework would:

- Distinguish between common law duties (in the specific context here, predominately one of fiduciary relationship) and statutory duties, identifying their sources and where there is overlap or interaction. This would assist a director to navigate through a complexity of rules and moreover, understand the purpose of the rules
- Provide a concise categorisation and discussion of the fiduciary rules – conflict, profit, and misappropriation
- Define the boundaries between fiduciary based duties and other duties, such as care and diligence
- Describe the division of powers, addressing where powers of management reside and what are the limits on such powers
- Discuss who it is that owes the duties, considering ancillary issues of delegation and reliance

- Describe to whom the duties are owed – again reinforcing the objective and fundamental nature of superannuation structures themselves. This would also enable some description of member rights and how they are pursued
- Identify who it is that enforces duties – thus addressing some elements of the enforcement framework, including some discussion of consequences of breach of duty

Recommendation:

CPA Australia recommends that an overarching principles-based governance framework be developed to improve the governance of the superannuation industry. From this framework, good governance recommendations could be articulated.

Part 3: Enhanced transparency

CPA Australia remains a supporter of reforms that enable improved transparency within the superannuation industry. Such transparency should provide superannuation fund members with relevant and useful information about their retirement savings including information on investment performance and details of portfolio holdings, with an ability to drill down to a level that provides meaningful information on how member funds are invested, and how well they are performing. Findings from research conducted by CPA Australia in 2011/2012 into the effectiveness of reporting by the superannuation industry identified various shortcomings and a need for improved transparency. We are pleased to note that progress is being made through legislation and regulatory requirements to address these issues.

We commend and encourage the continuing efforts by Treasury and other stakeholders in maintaining the momentum of the reforms process through the proposals in the Discussion Paper. We note that ASIC has undertaken consumer testing of the MySuper product dashboard and has subsequently published the findings from the testing undertaken. We recommend undertaking similar consumer testing of the choice product dashboard once the regulations are finalised and implemented, to identify any further potential improvements.

Recommendation:

1. CPA Australia recommends that Treasury and other stakeholders continue to undertake steps that enhance the transparency of superannuation.
2. Consumer testing of the choice product dashboard is conducted to gauge consumer response and identify any further improvements.

Part 4: Enhanced competition in the default superannuation market

Australia's superannuation system has evolved considerably since the days of award superannuation when there was a distinct industry fund for that particular industry. Most industry funds are now no longer restricted to any one industry and are public offer funds open to all employees, the self-employed and others. Since the introduction of Choice of Fund in 2005 they have been able to openly compete with other superannuation funds for members while maintaining relatively exclusive access to award employees due to the restricted selection process for inclusion in modern awards.

CPA Australia believes that in a choice environment all superannuation funds should be able to compete on an equal footing. The introduction of the MySuper products, with their required generic features, creates the level playing field on which all funds will be able to compete on equal terms. For the market to be truly competitive we believe employers should be able to nominate their default fund from the available MySuper funds. The nomination of default funds should be removed from modern awards.

Recommendation:

CPA Australia recommends that employers should be able to nominate their default fund from all available MySuper funds and the nomination of default funds should be removed from modern awards.

RESPONSE TO SPECIFIC FOCUS QUESTIONS

Our responses to specific focus questions follow. In providing our responses, we have not included questions where we have no comment:

Part 2: Better governance

2. *What is the most appropriate definition of independence for directors in the context of superannuation boards?*

There is doubtless merit in understanding independence in terms of being at arm's-length. The tendency in governance frameworks has been to provide more prescriptive definitions. However, structured 'list-type' approaches have a number of limitations and may distract from the essential attitudinal and behavioural characteristics of being able to bring to bear an independent judgment. Extension beyond the existing SIS Act description to that cited as defined in the Cooper Review would only be warranted if it were to add to the quality of governance practices particular to the industry.

3. *What is an appropriate proportion of independent directors of a superannuation board?*

Candidly, it is difficult and possibly inappropriate to provide definitive targets. Reference to other business forms, industries and structures is potentially deceptive. The ASX Corporate Governance Principles and Recommendations apply across a vast array of business size and types and are disclosed on an 'if not, why not' basis. The business models and commercial objectives of banking and insurance entities to which APRA's prudential standards apply, may be sufficiently discrete to warrant the majority requirement referred to in the Discussion Paper. CPA Australia considers more appropriate a different approach, where an overarching governance framework is developed, from which, in turn, threshold principles of good governance could then be articulated. This should provide a sounder basis for the operationalisation of good governance within corporate trustee entities. The approaches canvassed in the Discussion Paper, appear fragmented and present some risk of distracting attention away from critical attributes of fiduciary duty and beneficiary interest which are essential to superannuation.

4. *Both the ASX Principles for listed companies and APRA's requirements for banking and insurance entities either suggest or require an independent chair. Should superannuation trustee boards have independent chairs?*

Notwithstanding our comments immediately above, CPA Australia acknowledges an independent board chair as highly desirable and preferred practice.

5. *Given the way that directors are currently appointed varies across funds, does it matter how independent directors are appointed?*

6. *Should the process adopted for appointing independent directors be aligned for all board appointments?*

Underlying questions 5 and 6 are issues around the appropriateness of proportional representation. It would seem that the ensuing complexity referred to in the Discussion Paper might be best addressed through principle-based approaches which put to the fore fundamental aspects of beneficiary rights and associated duties, particularly those of a fiduciary nature. Representation is a second order consideration which of itself does not guarantee sound governance practice.

7. Are there any other measures that would strengthen the conflict of interest regime?

This is the area where perhaps the Discussion Paper falls short in reflecting the complexity and nuances of the governance issues involved. A number of matters need to be addressed in better communicating the governance issues at hand:

- The Discussion Paper quite correctly pays particular regard to conflict of interest. Conflict of interest is but one of a number of interrelated rules. The other fiduciary rules are the *profit rule* concerning misuse of position for the fiduciary's own or a third party's possible advantage and the *misappropriation rule* concerning diversion of property or opportunity. Any governance guidance for superannuation industry participants should also address these elements.
- The discussion paper draws a strong relationship between the presence of independent directors and the managing of potential conflicts of interest. Fundamentally, fiduciary rules are 'a counsel of prudence' that concern matters of attitude and aptitude. The mere presence of independent directors does not of itself guarantee the requisite behaviours.
- Further, whilst the Discussion Paper's reference to the maintenance of relevant interests is commendable, it does not touch upon the related complexities of director/ trustee decision making where participating in multiple boards, decision on dealings or transactions between related entities and circumstances where abstaining from voting is the appropriate prudent action.

8. In relation to board renewals, should there be a maximum appointment term for directors? If so, what length of term is appropriate?

Drawing on the ASX Corporate Governance Principles and Recommendations, length of tenure is an important governance issue. The proposed third edition includes as a relationship which may cast doubt on independence, the circumstance of where a director has been a director of the entity for more than nine years – the underlying assumption of three three-year terms. Without suggesting fixed prescriptive rules, CPA Australia acknowledges the importance of reviewing tenure and clear processes to handle renewals.

9. Should directors on boards be subject to regular appraisals of their performance?

Again drawing on the example and experience in developing the ASX Corporate Governance Principles and Recommendations, monitoring and evaluating board and management performance forms a key element in building and sustaining sound governance practices. These approaches are applicable across a range of entities and ought be applied to superannuation trustee boards.

10. Would legislation, an APRA prudential standard, industry self-regulation or a combination be most suitable for implementing changes in governance? What would be the regulatory cost and compliance impacts of each option be?

Consistent with our remarks above, CPA Australia urges development of a principle-based framework addressing the characteristics of the industry and its participants from which more practical guidance could be developed. Such approach may well develop through collaboration drawing on such experiences as the ASX Corporate Governance Council. Concerning regulatory balance, a blend of approaches seems appropriate, and indeed, inevitable. Legislation remains the critical bedrock for safeguarding superannuation beneficiaries and for addressing the errant behaviour of some participants.

11. What is the appropriate timeframe to implement the Government's governance policy under each option?

Notwithstanding our comments above, if the Government was to implement the proposed measures we would recommend that they do not commence before 1 July 2015, as RSEs continue to implement changes to comply with the new regulatory requirements stemming from the Cooper Review recommendations.

12. Given that there will be existing directors appointed under a variety of terms and conditions, what type of transitional rules are required?

Notwithstanding our comments above, if the Government was to implement the proposed measures we would recommend transitional rules apply at least until the end of the current term of each director's tenure.

Part 3: Enhanced transparency

13. Should a choice product dashboard present the same information, in the same format, as a MySuper product dashboard?

We support presenting information in the choice product dashboard that is largely the same information, and in the same format as presented in the MySuper product dashboard. This should allow for consistency in the information presented across all product dashboards, and enable comparison between choice and MySuper products as well.

We recommend the ability for members to "look through" the information presented in the dashboards for the benefit of those who wish to analyse the underlying detail. This may be particularly useful if there are likely to be differences in the inputs and methodologies used by different superannuation funds in calculating the information presented in the product dashboard. Such "look through" information should also include the methodologies used in calculating costs and fees, as there can be differences between superannuation funds in the methodologies used to allocate and calculate costs and fees. We note that consumer testing conducted by ASIC of the MySuper product dashboard also indicated support for a "look through" facility.

We also recommend an appropriate level of independent assurance of choice product dashboard information being presented. Such assurance requirements could be similar to those the requirements set out by APRA in SRS 700.0 for MySuper product dashboard information.

15. Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard?

We support inclusion of both the net investment return measure and net return measure in the choice product dashboard. We also support including the same information in the MySuper product dashboard. We believe this additional information is necessary to enable members to appreciate and understand the direct costs relating to investment management and the net returns achieved after deducting these costs.

16. Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure?

We support inclusion of both short-term and long-term risk measures. In our view both measures provide information to members on risks that affect their investments, and ultimately the estimated value of their retirement savings. We also recommend providing information on the assumptions made in relation to the variables used for long-term investment risk information, so that members are aware of the higher potential for volatility in the information presented on long-term risk measures.

18. Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?

We support inclusion of a liquidity measure in the choice and MySuper product dashboards but only to the extent that it may impact on the timing of redemptions from a fund, that is, to what extent will the liquidity of a fund prevent a member from withdrawing their money in a timely manner. We believe such information is only required by exception, that is, superannuation funds should be required to include liquidity information in the product dashboards only when liquidity concerns or constraints arise.

19. Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? If so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

We recommend a commencement date of 1 January 2015, to allow sufficient time for superannuation funds to establish systems and procedures to capture and present the information required.

20. Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs?

We support the first alternative model which requires the disclosure of direct fund holdings, with additional disclosure obligations placed on investment vehicles to disclose their fund asset holdings. Whilst we appreciate the difficulties with drill-down or look-through information for portfolio holdings in this manner, we believe this information is vital to ensure the system is and remains transparent into the future.

We recommend inclusion of a facility that allows members, if they so choose, to access portfolio holdings information on a full look through to the final asset. We would expect superannuation funds to possess such information for their own internal management purposes and therefore the additional effort required to provide such information is unlikely to be excessive.

23. *Is a materiality threshold an appropriate feature of portfolio holdings disclosure?*

24. *What is the impact of a materiality threshold on systemic transparency in superannuation fund asset allocation?*

25. *What would be the most appropriate way to implement a materiality threshold?*

We recommend no materiality threshold, i.e. require disclosure of all information in relation to portfolio holdings, as this is vital for transparency.

26. *Should the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014? If so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?*

We recommend a commencement date of 1 January 2015, to allow sufficient time for superannuation funds to establish systems and procedures to capture and present the information required.

Part 4: Enhanced competition in the default superannuation market

27. *Does the existing model (which commences on 1 January 2014) meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape?*

CPA Australia's primary concern with the previous process for nominating default superannuation funds in modern awards was the lack of transparency and the 'closed shop' nature of the arrangements. The fact that a fund could only be included in a modern award if it was the incumbent super fund, had the consent of the main parties to the award, or was able to apply as a party with 'standing' led to a narrow concentration of a relatively small number of funds being represented in modern awards.

While the new model addresses most of these concerns, the process is still closed to a certain extent in that superannuation funds are not able to make submissions to the Full bench of the Fair Work Commission to argue their inclusion or exclusion from the list of default funds in each modern award.

Further, limiting the number of default funds to fifteen lessens competition and may prevent all of the appropriate funds being included in a particular modern award.

28. If not, is the model presented by the Productivity Commission the most appropriate one for governing the selection and ongoing assessment default of superannuation funds in modern awards or should MySuper authorisation alone be sufficient?

Notwithstanding our previous comments that the most appropriate option to truly engender competition would be to remove the nomination of default superannuation funds from modern awards, we believe the model presented by the Productivity Commission would be the most appropriate one for selecting superannuation funds in modern awards.

In particular, CPA Australia supports the concept of the 'quality filter'. While having a MySuper product authorisation is an appropriate first filter, given the generic nature of MySuper products, being a MySuper product in itself is not necessarily sufficient to be selected as a default fund. As such, the second stage 'quality filter' of a broader set of selection criteria would ensure a selection can be made that is relevant to the needs of the employees covered by a particular award.

29. If the Productivity Commission's model is appropriate, which organisation is best placed to assess superannuation funds using a 'quality filter'? For example, should this be done by an expert panel in the Fair Work Commission or is there another more suitable process?

We believe an expert panel within the FWC as proposed by the Productivity Commission would be the most appropriate as it should ensure a more efficient process than if the FWC was dealing with an external body.

30. Would a model where modern awards allow employers to choose to make contributions to any fund offering a MySuper product, but an advisory list of high quality funds is also published to assist them in their choice, improve competition in the default superannuation market while still helping employers to make a choice? In this model, the advisory list of high quality funds could be chosen by the same organisation referred to in focus question 29.

Yes. Not only would it ensure a competitive environment for MySuper funds, the quality filter of the advisory list would ensure a selection can be made that is relevant to the needs of the employees covered by a particular award.

An advisory list would also provide a valuable tool to assist non-award employers to choose the most appropriate default fund for their employees or assist employees to choose a superannuation fund other than their employer's default fund.

31. If changes are made to the selection and assessment of default superannuation funds in modern awards, how should corporate funds be treated?

If an existing corporate fund meets the selection criteria of the 'advisory list' then it should be allowed to be listed, along with any appropriate MySuper funds, on a modern award that covers the employer sponsor's employees.