CORPORATE SUPER ASSOCIATION

ABN 97 799 893 065

PO box 508
Collins Street West VIC 8007
Tel: 03 8319 4075
Email: corpsuper@netspace.net.au
Website: www.corsuper.com.au

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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
P O Box 6100
Canberra ACT 2600

By e-mail to: corporations.joint@aph.gov.au

Dear Sir

SUPERANNUATION LEGISLATION AMENDMENT (TRUSTEE OBLIGATIONS AND PRUDENTIAL STANDARDS) BILL 2012

We refer to your Committee's inquiry into the above Bill.

Terminology used in this submission

Trustee Bill	Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012
EM	Explanatory Memorandum to the above Bill
The Association	Corporate Super Association

Background: the Corporate Super Association

Established in 1997, the Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors. We represent 35% of corporate fund assets and 30% of members of corporate superannuation funds. In general, these funds are sponsored by corporate employer sponsors with membership restricted to employees from the same holding company group, but we also include in our membership a few multi-employer funds with similar employer involvement and focus.

Many of the funds we represent include defined benefit divisions. Many of the defined benefit divisions are closed to new members, but there are also several that remain open. Many of the members are entitled to a combination of defined and accumulation benefits.

Trustee Bill

Our comments relate to:

- Trustee obligations, and uncertainties associated with fulfilment of trustee duties;
- Requirements relating to trustee bodies and individual directors;
- Trustee indemnities; and
- APRA's proposed powers.

MySuper trustee obligations under Division 6

Scale obligations: s 29VN(b)

The requirements of paragraph 29VN(b) (the "scale" test) will be very difficult for trustees to comply with because of lack of clarity in terminology and lack of certainty as to the benchmarks against which trustees are required to measure their fund. The paragraph requires trustees to measure the situation of their MySuper beneficiaries against the situations of MySuper beneficiaries in other funds, to determine if their own members' financial interests are affected by "insufficient" numbers in the fund as a whole and/or the MySuper product, or because of "insufficient" assets in the fund and/or the MySuper product. The difficulties with these requirements include the following.

Terminology

"Insufficient" is not defined: it could mean "insufficient to produce adequate economies of scale". In many respects, it is only in hindsight that the efficiency of scale arising from the level of assets, or of the pooling approach, or of the number of members, will be determined.

Benchmarks

Comparison with other funds would still seem to be required to determine whether, by comparison with other MySuper products, members' financial interests are affected. The only objective comparisons with other funds would seem to be in relation to historic performance and costs, in the context of the member numbers and assets. The link with performance is reinforced by the linking of the "scale" test to the investment strategy. We are not convinced that comparisons between funds or products will assist in determining whether investment and cost efficiency will be achieved through the dollar value of assets invested or through the number of member accounts.

The requirements of paragraph 29VN(b) (although not requiring equal performance) may in the context be interpreted by trustees as requiring performance equal to that of other MySuper products, and we are concerned about the potential convergence of investment strategies and trustee investment behaviours. We are also concerned that this incorporation of uncertain measures into the investment strategy makes the trustees' role in planning and setting an investment strategy almost impossible.

Need for a scale test

We question whether a "scale" test is needed at all. We believe that the investment and risk covenants for all RSE trustees are sufficient requirements that trustees should not be operating a fund or a MySuper product when assets and member numbers do not lend sufficient economies of scale to support a viable product. The issue of scale is a matter for judgement at the trustee level, and legislating regarding the exercise of judgement will fail to produce any certainty as to the requirements of the legislation.

Moreover, our understanding of the proposed CGT/Loss transfer relief provisions will necessarily preclude a Trustee forming an opinion as to the best interests of benefits in respect of 'scale'. Typically a Trustee would wait until APRA issued a direction so as to take advantage of the proposed concession. Our view is that the scale test be removed from the Bill until these issues are considered and addressed.

Role of trustees and of individual directors

Section 29VO and ss 52(2) and 52A(2): trustee and director skills

We believe that the Bill proposes a radical change to the required skill levels for trustee boards as a whole and further, for each individual director of a corporate trustee.

Trustee body

In relation to the corporate trustee, proposed paragraph 52(2) (b) relating to registrable superannuation entities generally contains the requirement for a trustee "to exercise, in all matters affecting the entity, the same degree of ***care, skill and diligence*** as a prudent superannuation trustee would exercise in dealing with property of an entity for the beneficiaries of which the prudent superannuation trustee was morally bound to provide" (emphasis added). In this context, subsection 52(3) states that a "superannuation trustee" is a person whose profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity. Hence the requirement for all fund trustees is the exercise of the level of skill (as well as care and diligence) expected of a professional superannuation trustee body. Whilst we support the principle of the concept that any superannuation trustee body should as a whole attain standards of care and diligence expected of a body that operates as "professional" trustee body, we are concerned that the enforcement of the legislation may focus on matters of form consistent with the operation of a professional trustee body and that valuable aspects of the operation of a body that acts for one fund alone may be ignored.

Individual directors

We are further concerned about the requirements that apply to all directors of the corporate trustee. Proposed paragraph 52A(2)(b) contains a requirement that each individual director of a corporate superannuation trustee exercise, in all matters affecting the entity, the same degree of ***care, skill and diligence*** as a prudent superannuation entity director would exercise in dealing with property of an entity for

the beneficiaries of which the prudent superannuation entity director was morally bound to provide (a "superannuation entity director" is defined as for s 27VO, as a person whose profession, business or employment is or includes acting as director of a corporate superannuation trustee and investing money on behalf of beneficiaries of the superannuation entity). Hence it appears an overriding requirement under explicit or deemed covenants that each individual director of a superannuation trustee exercise the skill expected of a person who operates as a professional superannuation trustee director. We find this requirement unreasonable in the context of a Government policy decision (in the response to the Cooper Report) to retain the equal representation arrangements, under which individual trustee employee representatives will not initially possess the same skills as those exhibited by the professional director. We endorse the Government's decision to retain the equal representation system, as we consider there is great value in running a fund with the involvement of such representative parties.

At paragraph 1.133 of the EM, it is stated that

The level of skill required does not necessarily require particular qualifications, and new directors will not be expected to have the level of skill and knowledge of an experienced director immediately. It is not intended that each director will have the same skills but rather that each understand the business of the trustee and its regulatory framework and be in a position to contribute to meetings of the trustee. APRA will provide further guidance on these matters.

We are concerned that this position is left for explanation in the EM and by APRA pronouncement and that the EM indicates an approach that may be more lenient than the legislation specifies. The legislation should be amended to reflect this position, which is otherwise uncertain.

We believe that as the legislation stands, employee representatives without investment management skills are going to be debarred from occupying the role. We also believe that the legislative requirement for individual directors to exercise skill as indicated will operate as a barrier to the admission of employee representative directors.

Comparison with State and Territory legislation

The EM states that the change brings the requirement in line with State and Territory trustee legislation as it applies to professional trustees. However the State and Territory legislation (for example, section 6 of the Victorian Trustee Act 1958) does not contain a universal requirement for all trustees to be professional trustees, nor to exercise the skills of professional trustees, nor does it contain a reference to the model for care, skill and diligence being a professional director *"investing money on behalf of beneficiaries"*, an addition which seems to import an implication that the level of skill required is not just that of a professional trustee director but one who has specific investment management expertise. We believe that this raising of the bar is not just a step but several significant steps, and well beyond the requirements applying under the Trustee Acts.

Diversity and representation

We believe that there remains value, in the context of funds for the benefit of employees of single employers or employer groups, in diversity of the persons occupying the role of trustee director, and in the representation of employee interests by persons who do not possess the formal skills and qualifications of members of trustee boards of commercial trustee organisations, still less that of investment management professionals. We believe that trustee directors drawn from the ranks of ordinary employees will provide an important contribution in the form of knowledge of the issues affecting the work force for which the employer sponsored fund is intended to provide. We also believe that it is going to be extremely difficult to find individuals in sufficient numbers with the proposed skills to occupy the director positions.

More importantly however the available statistical information clearly demonstrates that the equal representation model produces the best outcome so far as members are concerned.

Exposure to liability for trustees and trustee directors: s 55(5)

The proposed amendments to subsection 55(5) would provide a defence to an action for investment loss or damage for trustees and trustee directors **only if** they have adhered to all covenants under sections 52 to 54A as well as applicable obligations under sections 29VN and 29VO. This is a significant increase in requirements for a successful defence which previously only included compliance with investment covenants. In addition, the extension to individual directors and board members is a significant change from the existing application to the trustee as a whole.

We also believe that a defence should also be available in broader circumstances such as those where the breaches of the requirements are technical or minor.

Given the extension to the burdens of individual directors in section 52, 53 and 54A, we are particularly concerned regarding the impact and extension to liability for individual directors and members of trustee boards. The availability of persons to serve on boards will be constrained and the costs including that of indemnity insurance will be increased, to the detriment of fund members.

In view of the above, we believe that the changes to subsection 55(5) should be modified, preferably to encompass only the investment covenants, as previously. Further, the proposed covenants for individual directors should be abandoned, as the costs in terms of individual liability outweigh the proposed benefits of raising the bar for individual directors. We believe the latter object can be achieved by training and other requirements. We believe that parties suffering loss have sufficient recourse against the trustee as a whole and that it is not in the public interest that any aggrieved party be able to pursue individual directors.

Trustee indemnities, capital and risk reserve

S 56(2A) states that a trustee may not recover from the assets of a fund an amount expended from trustee capital that is maintained to cover occupational risk of the

fund. We understand that this means that in these circumstances trustee capital held for operational risk cover purposes can never be replenished other than from resources external to the fund. Whilst we would generally support this approach for professional trustee companies, we believe that in certain contexts it should be possible for trustees to be indemnified from the fund. These would include situations where the trustee acted for a single employer-sponsored fund and where a decision had been made to fund for operating risks through trustee capital rather than through an operational risk reserve. This decision could be made in particular where the fund provided defined benefits, hence funding of additional capital was effectively required to be provided by the employer and it was considered practical to provide the funding via trustee capital rather than additional contributions to fund a reserve. In such circumstances there is an argument for a level playing field in the matter of recoupment regardless whether operational risks are provided for from capital or a reserve.

We would also like to clarify whether and over what time period a trustee can be expected to draw on the assets of the fund to replenish an operational risk reserve within the fund. This is not clear from s 56(2A)(b). If the intent is that the operational risk reserve should be drawn on first, as available, and then gradually replenished, it would be helpful if this were made clear.

A further clarification is required regarding the types of expenses to which the above mentioned restrictions would be applied. Certain events may be regarded as normal operating events and these must be distinguished from matters requiring resort to operating risk capital or reserves.

APRA's standards making power

Draft legislation

The prudential standards making power under proposed section 34C is broad. Despite theoretical existence of safeguards applicable to legislative instruments, these are rarely applied. The draft EM states at 2.5 that prudential standards require extensive industry consultation as part of their development and ongoing revision. We would like to see this requirement stated in the legislation as well, and reflected in genuine process followed by the Regulator.

Proposed standards

We have made a separate submission dated 14 December 2011 to APRA regarding the proposed standards set out in the paper of 28 September 2011.

Our major concerns regarding the draft standards relate to:

- a potential undue burden of compliance complexity and documentation that is not commensurate with achieving better returns and transparency for fund members;
- potential confusion between standards and guidance material relating to the standards. We believe that the guidance material should merely explain the

standards and should not promote positions more extreme than those set in the standards;

- proposals regarding the composition of trustee boards. There are significant advantages in the existing equal representation model of board governance. The focus on independence in the proposed standards and guidance material should not detrimentally impact a model which recognises the value of employer and member participation in the governance of a superannuation fund;
- clarity regarding the establishment, access to and maintenance of operational risk reserves, including in the context of defined benefits. We recommend that APRA adopt an approach to operational risk reserves which recognises the actual risk profile of a fund and genuinely considers the impact of existing and future insurance;
- self-insurance. We believe there are significant arguments in favour of maintaining the ability for funds with adequate resources (and not just defined benefit funds) to self-insure, and that there are circumstances where self-insurance benefits members in terms of availability and cost of cover. In the context of the insurance strategy covenant under proposed s 55(7) the adoption of self-insurance in these circumstances would most appropriately meet the needs of, and avoid erosion of retirement income of beneficiaries;
- segregating defined benefit plans: there are practical issues for hybrid funds if DB assets are quarantined. These include economies of scale, availability of a surplus to fund an employer SG contribution holiday on behalf of the DC members and whether segregation is actually permitted by the trust deed;
- funding of defined benefits. We support the proposal that funding be to 100% of vested benefit level, but call for flexibility in adopting a funding strategy where the level falls below 100%, especially where further adverse market conditions occur during the funding process.

APRA's powers in relation to MySuper authorisation

APRA's power under draft paragraph 29U(2)(ca) to cancel a MySuper authorisation on grounds of contravention of section 29VO should be tempered. Cancellation of authorisation because APRA is no longer satisfied that directors are likely to comply with s 29VO could cause serious damage to a fund and its members and should be qualified by more specific requirements in relation to the forming of APRA's view, as well as time for correction and other remedies.

CGT relief

We believe that fund mergers will inevitably continue particularly in view of the various requirements in relation to MySuper. We take this opportunity to reiterate our view that relief should be provided in the form of preservation of capital and revenue losses of the fund which is to merge into another. This would minimise damage to the interests of members of the merged fund and would be consistent with prior policy of providing CGT relief when mergers are forced or motivated by regulatory change. Please note our comments above concerning our understanding of the proposed relief to be offered where funds are directed by APRA to merge.

Yours faithfully

Mark N Cerché
Chairman
Corporate Superannuation Association