

SUBMISSION

Submission to Treasury — Financial Accountability Regime

18 August 2021

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Director
Regulatory Powers and Accountability Unit
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The Treasury
Langton Crescent
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Via email: FAR@treasury.gov.au

18 August 2021

Dear Sir/Madam

Financial Accountability Regime – July 2021

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Financial Accountability Regime – July 2021.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16.5 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact Maggie Kaczmarska, Senior Policy Advisor, on (02) 8079 0849 or by email mkaczmarska@superannuation.asn.au.

Yours sincerely



Julian Cabarrus
Director - Policy Operations, Member Engagement & External Relations

General comments

ASFA appreciates Treasury's consideration and incorporation of industry's feedback in the Financial Accountability Regime (FAR) Exposure Draft Legislation. In particular the removal of the imposition of individual penalties and non-objections power from FAR, as proposed in Treasury's January 2020 FAR Proposal Paper, is welcome.

ASFA also welcomes the introduction of a materiality threshold to the notification obligations in relation to accountability maps and statements.

Specific comments

Proposed commencement date

The FAR is proposed to commence for RSE licensees from the later of 1 July 2023 or 18 months after the commencement of the FAR. ASFA recommends this proposed commencement date remain. It provides RSE licensees with time to ensure the organisation can transition to the new regime, particularly given resourcing constraints due to other reforms currently being implemented by the superannuation industry.

Changes to the proposed commencement date will also conflict with start dates and requirements under APRA Prudential Standard CPS 511 – Remuneration (CPS 511), potentially causing administrative inefficiencies including differences in interpretation and application.

Additionally, RSE licensees that are required to comply with the enhanced notification obligations will be required to provide accountability statements of accountable persons and an accountability map to APRA, as well as register all accountable persons. This will absorb significant time and resources of both RSE licensees and APRA in order to ensure that all the required regulatory approvals are in place in time for the commencement of the FAR.

Significant related entities

The factors that are outlined in subsections 11(3) and 11(4) in the FAR Exposure Draft could unnecessarily capture entities of RSE licensees that are created for the sole purpose of holding a particular asset on behalf of the RSE licensee. These 'investment vehicle entities' do not, generally, have decision making power nor have a substantial operational impact on the RSE licensee outside of holding the asset.

While subsections 11(3) and 11(4) are open to interpretation by the RSE licensee, in terms of determining which entities would be captured as a 'significant related entity' under the FAR, it would be beneficial to have guidance through the accompanying Explanatory Memorandum that the intention of the FAR legislation is not to capture these 'investment vehicle entities'.

As the FAR requires accountable entities to ensure their significant related entities provide accountability statements as if they were accountable entities, it would be a significant administrative and compliance burden for RSE licensees if these 'investment vehicle entities' were to be captured as a 'significant related entity' under the FAR when they are highly unlikely to have a material and substantial operational impact on the RSE licensee.

Deferred remuneration

While ASFA understands that the FAR will provide minimum requirements in relation to remuneration and allow for APRA to build on these requirements as it sees fit, it is important to ensure that CPS 511 is aligned with FAR and vice versa in areas where they do overlap to avoid confusion. For example, there is currently

inconsistency between the operation of subsection 26(2) of the FAR Exposure Draft and paragraph 52 of CPS 511.

Under the FAR, when determining the deferral period, subparagraph 26(2)(a) relates to a decision being made in relation to a person's total remuneration and subparagraph 26(2)(b) relates to a performance period for an individual. In practice while a performance period would, generally, encompass a year, the decision point for variable remuneration varies depending on the *type* of variable remuneration. For example, different types of variable remuneration could require the approval of shareholders during an annual general meeting, the Board and/or meeting some objective (e.g. length of service). This could make it incredibly difficult to determine the start date of a deferral period under the FAR.

Comparatively, CPS 511 considers forward looking performance measures when calculating the deferral period and takes a broader approach in determining the deferral period. These are not features of the FAR legislation. While ASFA understands that the final version of CPS 511 may be different to what was proposed in November 2020 following the release of the FAR Exposure Draft, as it currently stands there is inconsistency in determining the deferral period between CPS 511 and the FAR Exposure Draft.

There is also inconsistency between CPS 511 and the FAR in how to calculate the amount of variable remuneration that is to be deferred. Under the FAR it could be based on the value at the start of the minimum deferral period and calculated based on the maximum opportunity. Under CPS 511 it is based on the value of variable remuneration awarded. ASFA considers that the FAR should align with CPS 511 in this instance.

There is also a significant difference in the amount of variable remuneration that is required to be deferred under the FAR comparative to CPS 511. For example, the FAR requires at least 40 per cent of variable remuneration of directors (including the chief executive officer (CEO)) and senior executives to be deferred for a minimum of 4 years. CPS 511, by comparison, requires 60 per cent of a CEO's variable remuneration to be deferred over a minimum of six years.

ASFA considers that CPS 511 should align with FAR in order to ensure it does not inadvertently damage the calibre of talent in the superannuation sector over time, recognising that APRA-regulated entities are competing for talent with industries that do not need to comply with CPS 511 or FAR. It also creates a multitude of differing deferral thresholds across the superannuation sector depending on which provisions, whether they be legislative or regulatory, an RSE licensee is required to comply with.

Taxation consequences - remuneration

The taxation treatment of deferred variable remuneration remains unclear. For example, relevant individuals might need to pay tax on deferred variable remuneration when leaving an entity even though it has not yet vested. ASFA recommends Treasury clarifies with ATO the tax consequences of deferred variable remuneration for both entities and individuals. Outcomes from the discussion should be conveyed to the industry.

The clarification of the taxation treatment of clawback under APRA's CPS 511 would also be beneficial. For example, would entities required to recover the amount the individual received after tax and other relevant amounts had been deducted *or* the gross amount that an entity paid (including taxes already paid). Part of the variable remuneration could also have been paid into an individual's superannuation account, which could be difficult to access.

Accountability obligations and reasonable steps

The FAR establishes obligations of an accountable entity including requiring entities to deal in an open, constructive and cooperative way with APRA and ASIC. This is quite an ambiguous obligation. Under current obligations RSE licensees are required to cooperate with regulators and fulfil their regulatory functions in order to operate as an RSE licensee. It is a part of their licensing requirements. It would be beneficial to understand how this differs from existing obligations.

More broadly, it would also be useful to gain a deeper understanding of the meaning and purpose of each of the accountability obligations. Accountable entities and persons need to understand and be aware of what these obligations require of them in order ensure compliance with them.

For RSE licensees in particular, they are already subject to a number of existing legislative obligations and fiduciary duties. The fiduciary role of a superannuation trustee requires trustees to broadly:

- Comply with the trustee deed governing the superannuation fund
- Act in the best interests of fund members
- Resolve conflicts of interest or duty by giving priority to members' interest, and
- Exercise a prudent degree of care in investing the fund assets.

In addition to these, superannuation trustees are subject to mandatory covenants under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Both the duties under general law and the SIS Act are an essential part of the environment in which a superannuation trustee's governance framework must operate and differentiates Trustee Boards from public company boards.

As such, where the FAR obligations replicate what is currently required of RSE licensees, ASFA recommends that existing obligations are referenced. At the very least, the same language and guidance should be used to describe these obligations to avoid confusion in interpreting another set of duties.

In fulfilling accountability obligations, an accountable entity is required to take 'reasonable steps'. It is not clear what 'reasonable steps' means. It is important to ensure that, when considering whether an accountable entity took 'reasonable steps', it is not assessed with the benefit of hindsight. Rather it should be assessed based on the circumstances of the accountable entity at the time the conduct being assessed occurred. It would be beneficial to understand, and receive guidance on, what 'reasonable steps' can be taken to avoid the contravention of these provisions.

Notification obligations

The FAR requires accountable entities to notify regulators of certain events within 30 days of the event occurring unless a regulator provides for a longer period of notification. Ordinarily, 30 days would be sufficient time to provide the required notification to the regulator. However, there are a significant number of RSE licensees that are currently in the process of undertaking successor fund transfers (SFTs). This higher level of merger activity within the superannuation industry is likely to continue in the immediate future.

A SFT is a complex and lengthy process to undertake for RSE licensees, requiring the integration of a number of different processes and systems. Depending on the size and level of complexity in integrating merging superannuation funds, transitional activities can run over a number of months or years with constant change occurring throughout the integration process.

While an RSE licensee can track how accountabilities are moving during this transition, the notification obligations could require a significant number of notifications being provided to APRA during the transition

within 30 days. As such, notification obligations under the FAR could tie up a significant amount of resources for merging superannuation funds. ASFA recommends regulators consider transitional notification obligations for superannuation funds that are undergoing SFTs.

Variable remuneration

As ASFA has raised in previous submissions to APRA in relation to CPS 511, variable remuneration continues to be viewed within both the FAR and CPS 511 as an accountability component for an organisation to show that there is effective risk management when making decisions. This implies that variable remuneration may be required for RSE licensees in order to ensure that appropriate incentives are set for employees.

Not all RSE licensees have variable remuneration. The choice of having (or not) variable remuneration is made by each RSE licensee based on their individual circumstances. ASFA recommends that there be absolute clarity on whether there are other consequence management systems that need to be in place for organisations that do not have variable remuneration for their accountable persons.

It would also be beneficial to receive guidance in relation to how reductions in variable remuneration, where there has been an accountability failure, should work in practice. That is, the factors that the entity will need to consider in calculating the reduction and case studies that step through how it is to be calculated.

Regulatory guidance

ASFA recommends that updated regulatory guidance in relation to the FAR and remuneration be released as soon as possible to support the effective implementation of the requirements, including requisite approvals from APRA. For example, guidance in relation to what are the requirements of accountability statements and maps would help ensure a more efficient transition to the FAR for both the regulators and the superannuation industry.