A Submission to the Financial System Inquiry

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Introduction:

The power of the financial markets, including the superannuation funds and funds management sectors wield considerable power in the Australian economy. This power must never be under-estimated. The public should continually ask the following questions:

1 Who are actually controlling and managing the funds?

2 How effective is the *governance framework* within the financial sector?

3 Are the people managing & controlling the funds ethical & competent?

4 Do these people, viz, the directors & senior managers actually understand the high risks when these funds deal in complex financial derivatives? Or are they too embarrassed to say that they don't know about the risks involved in those financial instruments?

5 What level of "stress-testing" is performed by the directors, funds managers, etc who manage at least $1.3 trillion of superannuation funds? How often? Is the "stress-testing" robust enough? How good is the assets-allocation policy?

(A) Need for proper & effective governance

Too many large super funds directors are not "democratically" elected, eg, it is arguable that individual members do not have a vote in electing **all** individual directors to the board of a large superfund. There is obviously an "in-balance" in the power struggle within such boards. The voting model (whereby all shareholders have a say in the election of directors) adopted by the publicly listed companies should be adopted for all major financial institutions.

The systems & processes for assessing the performance of individual directors are too often *ad hoc* and rely heavily on a small group of consultants who may or may not be fully **independent** and who do not fully understand the governance requirements of the organisation. It would appear that the Chairperson of each company has enormous power & input in the performance evaluation of each individual director; this could result in a weakness in the governance framework.

Recommendations:

1 Have more democratically elected directors

2 Directors should stay for a maximum of say 5 years, unless of course he or she "owns" the company

3 All investments by the company must be fully disclosed to the members

4 More independent directors should be appointed to all boards, eg, a majority of independent directors should b appointed.

(B) Need to adequately disclose re: financial derivatives

"Derivatives are easy to enter into but difficult to exit", in the words of a prominent funds manager.

There is a high risk when the financial regulators quite often don't understand the intrinsic risks in these high-risk financial derivatives. There is a risk that the regulators are too afraid to say that they do not have the sufficient expertise to assess these risks.

Recommendations:

Regulators should identify fully the key risk scenarios for all financial transactions; eg, assess the nature & risk of individual source of revenue for each financial organisation.

(C) Need for the regulators to be more pro-active

Regulators should report all key risk issues / key risk scenarios affecting each financial institution to the stakeholders.

(D) Management expenses of financial institutions

Annual financial reports these days are filled with many pages on how senior management, CEO, board members, etc are being remunerated, eg, via issuance of share options, etc. These information is getting too complex for the ordinary shareholders to comprehend and could be meaningless to many shareholders. However, there should be more details on management expense such as travel expense, entertainment expense, cost of training, costs of attending conferences, etc

Recommendation:

A better and more comprehensive list of management expenses should be disclosed to all stakeholders.

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