



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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Expert Review Panel
Clean Energy Finance Corporation Expert Review

Email: cefc@treasury.gov.au

Dear Ms Broadbent, Mr Paradise and Mr Moore

Clean Energy Finance Corporation Expert review: Governance arrangements of the CEFC

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act), with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies, government-owned corporations, not-for-profit organisations and other public sector agencies.

CSA welcomes the opportunity to comment on the Clean Energy Finance Corporation: Expert Review. We will for the most part confine our comments to the governance arrangements.

The terms of reference for the review have asked for suggestions of appropriate governance principles and mechanisms for the CEFC, including:

- responsibilities, powers and statutory duties of office holders including the board, chairman and chief executive officer
- appropriate board structure, representation and skills
- reporting obligations of the board;
- relationship between the board and responsible Ministers, and
- duties and functions of the CEFC employees.

We also believe that the organising structure of CEFC is relevant to governance.

General comments

Commercialised government entities, whether they are operating under enabling legislation or other legislation with key governance requirements, are a part of the complex Australian public governance landscape. The high levels of public accountability that apply to commercialised government entities as a result of their public ownership make their corporate governance very important. The corporate form was chosen for commercialised government entities as it best provides a separation on an arms' length basis between government and the enterprises it

creates to distance government and allow management of the enterprise to focus on the business of the particular enterprise.

Some of the challenging issues and their implications for good governance were examined through a national benchmarking survey of these entities undertaken by CSA in 2009. We surveyed governance practices in government commercialised entities, that is, government-owned corporations (GOCs), government business enterprises (GBEs), state-owned corporations (SOCs) and government trading enterprises (GTEs).

The key governance issues that were considered in order to understand if a governance framework was in place for a commercialised government entity were as follows:

- the identities and roles of the key stakeholders (for example, board of directors, members, executive management)
- the powers vested in each stakeholder and the basis on which such powers rest
- the reporting responsibilities of each stakeholder and the identity of the stakeholder to whom those reporting obligations are owed
- the extent of the board's decision-making powers, the members' decision-making powers, and executive management's decision-making powers.

Reflecting on these, some of the questions that arose were:

- Are the boards of commercialised government entities able to act as governing boards, with full power to act in the best interests of each company to achieve economic efficiency?
- Are the role and functions of boards ambiguous, in that their roles, functions, responsibilities and public accountability may overlap with those of Ministers?

If the identities and roles of the key stakeholders are confused, then the governance framework is in question and it is difficult to see how the corporate form can provide the economic advantage it is meant to.

A copy of our report is attached for reference.

A review of state-owned corporations conducted by the NSW Government in 2000¹ noted, in relation to the separation of powers, that:

- the Minister's ability to issue directions in regard to a board's activities should be subject to clear limits
- the Minister should not be able to give directions to the board in terms of the exercise of the board's statutory powers and duties
- any Ministerial directions to the board in regard to its activities should be in writing and publicly reported
- there should be clear and agreed provisions for boards to refuse these Ministerial directions, and
- where Ministerial directions are imposed, there should be agreed provisions for boards to seek compensation for implementation of Ministerial directions.¹³

Insulation from political influence can be bolstered by vesting real authority in the board. While the government, as the shareholder of an enterprise, has a legitimate right to influence the entities within its portfolio, its sphere of influence should be limited. Appropriate roles for government include setting overarching objectives and performance targets for shareholder return, but not setting strategic direction, which is the role of the board. It is also not appropriate for the shareholder to derail strategic plans set in place by the board by insisting on a change in direction according to a shift in policy. Other appropriate roles for government are consulting

¹ Smith S, 2000, *State Owned Corporations: A Review*, NSW Parliamentary Library Research Service Briefing Paper No 11/2000

with boards on director nominations, but the boards should appoint their own directors according to the selection criteria best suited to the entity's circumstances.

CSA recommendations on governance arrangements

Organisation structure

CSA notes that fundamentally different governance consequences flow from the organisational status accorded to CEFC.

CSA is of the view that the threshold issue of what form this body should take is critical. Currently it is impossible to definitively work out what that organisational form should be without greater clarity as to the government's intent.

Reference has been made to the Export Finance and Insurance Corporation (EFIC) as an example of the governance arrangement for the proposed CEFC.² Established in its current form under the *Export Finance and Insurance Corporation Act 1991*, the EFIC is an independent statutory corporation wholly-owned by the Commonwealth of Australia. As set out in the Statement of Expectations, EFIC operates under a 'market gap' mandate — it is only to provide services to viable projects where the private sector is unwilling or unable to provide support. While the EFIC is not required to comply with the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, it reports against a modified version of them.³

The terms of reference refer to the *Governance Arrangements for Australian Government Bodies* (August 2005); however, no reference is made to the *Commonwealth Government Business Enterprise Governance and Oversight Guidelines* (October 2011), further adding to the uncertainty as to the form this body will take. CSA notes that it is not possible for a board to put in place a governance framework if the organisational form is not clear. Any governance arrangements will also be dependent on clarity as to the commercial aims and the societal aims of the CEFC, as managing the tensions between these two objectives will be a challenge for the board.

There must be a clear definition of the proposed organisational status. Given the very commercial nature of CEFC and a requirement for this organisation to act in its own best interests, **CSA recommends** that CEFC should:

- be established as a Corporations Act company that can act independently and has its own financial and organisational arrangements
- have a clear separation from Commonwealth departmental structures and activities.

CSA also recommends that the CEFC's role should be clearly established in a basic governing document — a constitution or similar constituent document. Within the broad constraints in this document and given the CEFCs commercial role, the strategic and operational independence of CEFC should be paramount.

In addition, **CSA recommends** that there should be a clear documented definition of the Commonwealth Government guidelines, policies and Ministerial directions. CSA is of the view

² Senator Penny Wong, Minister for Finance and Deregulation, 'I make the point that the government is establishing this corporation as a body independent of government, to be run by a board of private sector experts ... The government will obviously be informed by its experience with bodies such as EFIC, which is the Export Finance and Insurance Corporation', <http://www.openaustralia.org/senate/?id=2011-10-13.258.2>

³ <http://www.efic.gov.au/about/governance/framework/Pages/ASXcorporategovernanceprinciples.aspx>

that this is an area that requires careful consideration, as the application of such guidelines, policies and directions is often an area of conflict for government-owned corporations that are mandated to act commercially, as they can be constrained in this respect by the application of public service policy guidelines or policies.

Documentation

Key private sector standards of corporate governance are relevant to inform the practices and procedures for the boards of government businesses. It is acknowledged that the context of government ownership creates different circumstances for such boards, be they governing or advisory boards.

Notwithstanding this, the guidance provided in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* and the *Commonwealth Government Business Enterprise Governance and Oversight Guidelines* would be useful to refer to.

At common law and under statute, directors of companies have a fiduciary duty to act in the best interests of the company as a whole. This fiduciary duty is applicable to those serving on the boards of government businesses. However, when the government is the sole or majority voting shareholder in the government business, the board is accountable to a Shareholding Minister. It is highly desirable for a Shareholding Minister to avoid becoming a 'shadow director' who may be taken to act as a director. This can be achieved by clarifying the (limited) shareholder powers and responsibilities, for example, in terms of:

- exercising decision-making powers on **key** issues
- setting the broad strategic direction of the business
- appointing the chairman of the board
- board remuneration
- appointing or being consulted on the appointment of directors and/or the chief executive.

Consequently the role, powers and delegations of any shareholding Minister(s) should be clearly documented — refer to our comments above in 'Organisational structure'.

Additionally, CSA recommends that the CEFC document:

- the function of the board (governing)
- the identities and roles of the key stakeholders (for example, chairman, directors, chief executive)
- the powers vested in each stakeholder and the basis on which such powers rest (for example, do the powers arise from legislation?)
- the reporting lines of each stakeholder and the identity of the stakeholder to whom those reporting obligations are owed (for example, does the chief executive report to the board or to the Shareholding Minister directly?)
- whether the relationships between the CEFC and stakeholders are formally based in a performance agreement, and the frequency of review of any performance agreement, its nature and attendance.

Statement of matters reserved for the board

An advisory board provides expert advice to the Shareholding Minister and senior executives. A governing board is empowered to set the strategic direction and oversee the management and performance of the state-owned corporation.

CSA recommends that the governance arrangements clarify that the board of the CEFC is a governing board.

CSA recommends that the board of CEFC:

- sets the strategic direction of the business (within any broad parameters set by the constituent document and/or lawful direction from the Shareholding Minister)
- appoints the chief executive or managing director
- determines the remuneration of the CEO
- has responsibility for risk management oversight
- has responsibility for nominations for board appointments to the Shareholding Minister, with clarity that it is the board that is best placed to select candidates to ensure the collective skill mix of the board reflects the commercial, financial and sector nature of the CEFC's operations.

The governance arrangements need to consider the following matters when drawing up the board charter. It needs to be decided over which of the following the directors will have direct control or oversight:

- nomination and appointment of directors, membership and role of board subcommittees and assessment of board performance
- appointment, remuneration and assessment of performance of chief executive officer and other members of the senior management team
- delegation of powers and authorities to management
- corporate governance matters, including frequency and agendas of board and committee meetings, and the appointment of the company secretary
- matters pertaining to shareholders including meetings, communications and relations
- monitoring of company performance
- approval of annual reports and accounts
- directors' interests, conflicts of same and related-party transactions
- oversight of compliance with appropriate laws and regulations and major litigation
- recommendations by management in respect of finance matters, internal and external audit, operational matters such as business strategy, operating budgets, risk management, human resources and sustainability policies
- significant loans, mergers, acquisitions, restructures and divestments
- approval of key company policies
- director and executive succession planning
- appointments to subsidiary company boards.

The ASX Corporate Governance Council's corporate Governance Principles and Recommendations are used as the foundation for a governance framework by many commercialised government-owned entities and CSA encourages the CEFC to examine how best to translate these guidelines for its use.

Conflicts of interest policy and related party transactions

The CEFC board also needs to consider how it will manage conflicts of interest, related party transactions and the delegation of authority. Governance arrangements in these areas need to consider personal and group behaviours, and their management is central to the organisation's ethics and culture. These issues should be addressed in a conflicts of interest policy.

Directors on the board of a government business have a fiduciary duty under common law (and, if the business is incorporated under the Corporations Act, under statute) to act in the best interests of the organisation they serve. Directors should not benefit from the government business, and should not be influenced by their wider associations when making decisions that affect the government business.

The appearance of impropriety is one of the biggest risks of a conflict of interest, so it is important that the government business can demonstrate that there are policies and procedures in place to guide directors in acting appropriately.

CSA recommends that the conflicts of interest policy address:

- the requirement for directors to have regard to their pecuniary interests to ensure they have no conflicts of interest
- the requirement that directors will declare their interests on appointment and subsequently as and when they arise, and the process for advising the government business of such interests
- the requirement for such interests to be entered on a register of interests that may be open to public scrutiny
- not only the obligations of all directors, including ex officio, nominated or representative board members, but also the process for identifying and addressing any potential conflict of interest that may arise from time to time the relationships of directors with lobbyists (particularly with regard to the issue of the perception of the nature of the relationship)
- the modes of resolution available so that directors are clear how any actual or perceived conflicts of interest will be dealt with the process to be followed in relation to directors' dealings with related parties, including in relation to procurement processes.

Directors' handbook

It is also good governance to consider developing a directors' handbook, containing not only the code of conduct and conflicts of interest policy, but also

- directors' duties and liabilities
- the organisation's expectations of the director
- how board members can raise concerns outside board meetings
- the ability of directors to seek independent professional advice
- reporting lines
- the protocols of dealing with politicians or media
- the relationships of directors with lobbyists (particularly with regard to the issue of the perception of the nature of the relationship), and
- the relationships between the key stakeholders involved in the governance of the organisation.

Delegation of authority

To the extent not clarified in any basic constituting document(s) or governing legislation, **CSA recommends** that there should be documentation of:

- whether and to what extent any decision-making has to be referred by the board to relevant Shareholding Minister(s) — for example, is there a level of proposed lending or investment by CEFC above which the decision must be referred to the Shareholding Minister(s)? Are there to be investment requirements or guidelines that the CEFC must operate within?
- the extent to which the Shareholding Minister(s) can give directions to the CEFC — for example, can the responsible Ministers direct CEFC to undertake non-commercial loans in certain circumstances?

Directors of a government business have discretion conferred upon them by the Corporations Act (if the organisation is incorporated under the Act) and may also have discretion conferred upon them by the enabling legislation. The board may be able to delegate some of its functions.

CSA recommends that the board of a government business should:

- develop charters/terms of reference for any board committees established by the board
- establish the basis of the power of the board committee, that is, whether it is advisory or delegated, and the extent of the committee's authority
- ensure that each committee of the board provides the board with regular reports of its activities
- establish the process for setting up and terminating ad hoc committees including formalising their terms of reference and membership
- clarify its expectations of management and monitor whether those expectations have been met, including clarification of whether the board uses the CEO or equivalent as a single point of delegation and holds this position accountable for meeting all the board's expectations for organisational performance
- clarify the limits of financial authority delegated to the CEO or equivalent and any other limits to executive activity that the board sees fit to put in place
- ensure that where delegations are exercised, that an appropriate system for the oversight of the exercise of those delegations is in place, monitored by management or the board as appropriate.

Reporting

To the extent not clarified in any basic constituting document(s) or governing legislation), **CSA recommends** that there is documentation clarifying the type, level and frequency of reporting (including financial reporting) to the Shareholding Minister(s). Again, clarity and transparency of any such reporting regime is essential so that all stakeholders are clear as to expectations and requirements. This also assists in building relationships between the board and the responsible Minister(s).

Continuous disclosure

CSA notes that continuous disclosure is an issue for government-owned corporations when they are mandated to act commercially. (This is particularly so if the organisation is included within the scope of freedom of information regulations — the conflict between preserving confidentiality of commercial information and freedom of information disclosure is exacerbated). The concept of continuous disclosure is entrenched in the private sector, where there is a statutory obligation and a Listing Rule applicable to listed entities, requiring an entity that becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities to immediately notify the market of that information. The key to the continuous disclosure regime for private sector entities is materiality.

Without materiality as the key to a continuous disclosure regime, real questions arise as to how a public sector agency can make decisions as to:

- What should be disclosed?
- When should it be disclosed?
- Why is it being disclosed?
- To whom does it need to be disclosed?
- How to effectively make that disclosure?

Government-owned corporations may have policies which more closely align, either voluntarily or by instruction, with the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* that support disclosure. However, those that operate in a competitive environment need to ensure that commercial-in-confidence information is preserved.

CSA recommends that the CEFC not be subjected to freedom of information regulation and that the CEFC follow disclosure principles similar to the ASX Corporate Governance Council's Principles and Recommendations.

Staffing

There is a need to clarify the employment status of staff. For example, are they public servants governed by the Public Service Act or employees of the CEFC company? Establishing the employment regime is also essential in clarifying employee rights, duties and responsibilities.

CSA recommends that there is a clear staffing regime from the commencement of the CEFC and that staff should be the employees of the CEFC company. This affords the chief executive the most flexibility in developing strategy to promote the commercial interests of the CEFC.

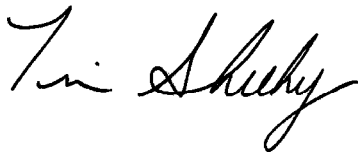
Conflict with other legislation

There is likely to be some potential for conflict in the operation of other legislation in respect of the CEFC. **CSA recommends** that a review (and subsequent documentation) is undertaken clarifying the extent of the application of legislation such as the *Freedom of Information Act* to the CEFC, and the implications of that in relation to the CEFC's need to preserve commercial confidentiality.

Conclusion

In preparing this submission, CSA has drawn in particular on the expertise of its Public Sector Governance Committee, all of whose members have experience in developing and implementing governance frameworks in public sector agencies, including in government-owned corporations. We would be more than happy to meet with the CEFC Expert Review panel to discuss these matters further, should that be of assistance. We would also welcome a future consultation relating to the form of legislation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tim Sheehy', written in a cursive style.

Tim Sheehy
CHIEF EXECUTIVE