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23 July 2015

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

Email: superannuationgovernance@treasury.gov.au

Dear Sir/ Madam

Governance arrangements for APRA regulated superannuation funds

The Australian Institute of Company Directors (AICD) welcomes the opportunity to make this submission with respect to the exposure draft of the *Superannuation Legislation (Governance) Bill 2015: Governance arrangements for APRA regulated superannuation funds* (the Exposure Draft).

The AICD is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. We have a significant and diverse membership of more than 36,000 from across a wide range of industries, commerce, government, the professions, private and not-for-profit sectors.

Executive summary

In summary, our comments are as follows:

- It is our long-held view that greater independence on the boards of superannuation trustee companies should be encouraged, consistent with internationally recognised principles of good governance. The AICD welcomes the Government's commitment to improving superannuation governance and encouraging greater independence through the introduction of the Exposure Draft;
- To the extent possible, all APRA-regulated entities (including superannuation funds) should be held to the same standards of governance;
- Given the current board composition of the boards of most industry superannuation fund trustees, the proposal under the Exposure Draft to introduce a requirement that at least one-third of the board be independent and allowing a three-year transition period to comply is supported;
- We endorse changes to introduce an "if not, why not" disclosure of whether there is at least a majority of independent directors on the trustee board;
- We endorse that the requirement that the Chair of a superannuation trustee company's board be independent; and
- We recommend that a broader definition of "independent" be adopted under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) for directors of superannuation trustee companies, similar to the one that is used for the purposes

of Principle 2 under the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (Principles and Recommendations). Guidance by way of specific examples of relationships that are likely to indicate that a director is not independent (similar to those provided in Box 2.3 of the Principles and Recommendations but adapted to reflect the unique relationship between some directors of a superannuation trustee and employer or employee groups) should be included in the relevant prudential standard and not in the SIS Act itself.

Mandating levels of independence on boards

While other APRA-regulated entities continue to be held to mandated standards of governance, to the extent possible, superannuation funds should be held to the same standards of governance.

The AICD also endorses the requirement that the Chair of a superannuation trustee company's board should be independent introduced into the SIS Act.It is widely accepted that independent directors play an important role in achieving good governance. We note, for example, that:

- The Organisation for Economic Co-operation and Development (OECD) recommends that boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgment to tasks where there is a potential for conflict of interest;[1]
- The ASX Corporate Governance Council recommends that a majority of the board should be independent directors;[2] and
- The Australian Council of Superannuation Investors (ACSI) considers that a board should be comprised of a majority of independent non-executive directors who are sufficiently motivated and equipped to fulfill the function of independent scrutiny of the company's activities.[3]

Additionally, APRA has demonstrated support for the inclusion of independent directors on the boards of organisations in other industries. Paragraph 19 of Prudential Standard CPS 510 provides that the boards of authorized deposit-taking institutes, general insurers and life companies must have a majority of independent directors at all times.[4]

The AICD considers that independent directors can make a valuable contribution to the boards of superannuation trustee companies and good governance recommends that at least a majority of the directors on the board of a public company be independent. This is particularly true for entities with responsibility for public funds. There are a variety of reasons why independent directors are considered important for good governance; however, the significance of any particular reason may vary depending on the type of superannuation entity. The Super System Review of the governance, efficiency, structure and operation of the superannuation system (Super System Review)[5] recognised, for

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[1] OECD Principles of Corporate Governance, 2004, Principle VI.E(1), http://www.oecd.org/dataoecd/32/18/31557724.pdf

[2] ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3rd ed*, Recommendation 2.1

[3] ACSI Governance Guidelines: A guide for superannuation trustees to monitor listed Australian companies, July 2011, principle 5(d), http://www.acsi.org.au/images/stories/ACSIDocuments/cg_guidelines_2011_final_version_22.06.11.pdf

[4] APRA, Prudential Standard CPS 510: Governance, July 2012, http://www.apra.gov.au/CrossIndustry/Documents/Prudential%20Standard%20CPS%20510%20Governance.pdf

[5] Super System Review chaired by Jeremy Cooper, Final Report, http://www.supersystemreview.gov.au

example, that independence from management is important for retail funds, while an "outside perspective" is important for industry funds.[6]

The AICD also considers that there are other important reasons to include independent directors on the boards of superannuation trustee companies that are currently subject to the equal representation requirements in Part 9 of the SIS Act (or where a board otherwise comprises only employer and member representatives). These reasons include:

- Independent directors can represent and protect the interests of significant groups that are unrepresented under the equal representation model. The Super System Review found that employer and employee representatives are often nominated by third party organisations, such as employer associations and trade unions, which do not necessarily represent the interests of all employers or employees.[7] Similarly, there are other key groups, which are growing in size and are unrepresented under the equal representation model, including retirees, ex-employees and members who have joined funds by exercising fund choice;
- Independent directors can assist employer and member representatives by providing a fresh perspective, as well as bringing different skills and knowledge, particularly where member representatives and employer representatives may have had similar backgrounds, experiences or training. This would assist in ensuring there is an appropriate balance of skills, knowledge, experience and diversity represented on the board to enable it to discharge its duties and responsibilities effectively;
- Independent directors can bring specialist skills and knowledge to the board, including investment, finance, director or trustee experience, which employer and member representatives may lack; and
- Independent directors may be able to reduce the risk of industrial instability, which is inherent in the equal representation model.

While having at least a majority of the directors on the board is desirable, what is important is that there are enough independent directors on the board to genuinely influence and affect the decisions of the board. Given the current structure of most industry superannuation funds and the composition of their trustee boards, we support the proposal under the Exposure Draft to introduce a requirement that at least one-third of the board of all superannuation fund trustees be independent and allowing a three-year transition period to comply.

We also endorse the proposed changes to the reporting requirements for superannuation funds under the Corporations Regulations to introduce an "if not, why not" disclosure of whether the trustee board is comprised of at least a majority of independent directors. We are of the view that this is likely to encourage more boards to move beyond the one-third required towards what is already considered good practice for listed companies and is in fact already required of other APRA-regulated entities.

Appropriate definition of "independent director" for superannuation funds

In defining the term "independent director", it is important to recognise that the determination of a director's independence involves an assessment of whether the director is, as a matter of practice, in a position to exercise independent judgment as a director. This assessment needs to be able to take into account a number of factors that

[6] Super System Review, *op. cit.*, s.4.3
[7] Super System Review, *op. cit.*, s.4.2

may impact on the director's ability to exercise independent judgment. For instance, it would seem unlikely that a director appointed as a nominee could be independent as their relationship with the nominator will make it difficult to exercise independent judgment as a director.

As noted in our previous submissions to Treasury[8], a director's independence cannot be assessed strictly against set criteria, nor can it be based on any one factor. While we agree that there are certain relationships that are likely to be relevant to the board's consideration of a director's independence, it is the view of the AICD that independence should not be defined by reference to a list of indicative factors based on the director's relationship with the company.

There are a number of factors that may impact on a director's independence, and many of these are captured in Box 2.3 of the Principles and Recommendations, and also in the proposed definition of "independent" that has been included in section 87(1) of the Exposure Draft. The flexibility of the "if not, why not" approach taken under the Principles and Recommendations encourages boards to put in place the best corporate governance arrangements for their companies' particular circumstances, and this includes the determination of whether a director is independent. A board can be expected to take into account all relevant interests, positions, associations and relationships that could impact on a director's ability to exercise independent judgment – but the board's assessment should ultimately be made based on whether the director is in fact independent of mind and in practice exercises their judgment in an unfettered and independent manner. The regulatory regime for the financial sector should not distort their decisions and business judgments on these matters, but rather should allow the regulator to be assured that governance standards are being satisfactorily met.

The AICD recommends that a broad description of "independent" be adopted for directors of superannuation trustee companies under the SIS Act, similar to the one that is used for the purposes of Principle 2 under the Principles and Recommendations, namely:

> *"An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgment."*

Recognising that APRA will have the ability to specify the types of relationships that are likely to indicate that a director is not independent, we recommend that specific examples of these relationships be included in the relevant Prudential Standard (which we assume will be Prudential Standard SPS 510) to provide further guidance to superannuation trustee boards. Ideally, the guidance in the Prudential Standard would recognise that the existence of any of these relationships is just one consideration to be taken into account by the board and by APRA and that, ultimately, independence is a matter for determination by the board based on whether the director is in fact independent of mind and in practice exercises their judgment in an unfettered and independent manner.

However, we acknowledge that this has not been the approach taken by APRA for the other entities it regulates when determining whether a director is independent. In Prudential Standard CPS 510, APRA has listed a number of relationships that, if exist, automatically mean that a director will not be independent for the purposes of the standard.

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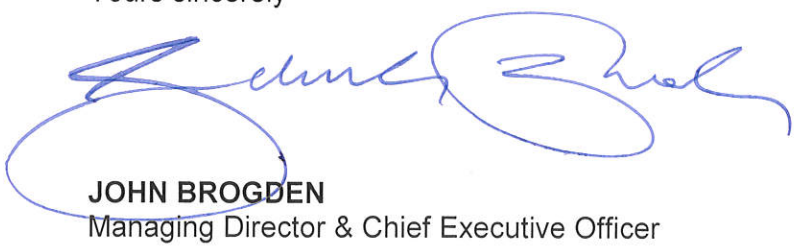
[8] AICD submission to Treasury in response to the recommendations set out under the Financial System Inquiry Final Report dated 31 March 2015; and AICD submission to Treasury in response to its Discussion Paper, *Better regulation and governance, enhanced transparency and improved competition in superannuation* dated 12 February 2014

While we do not agree with this approach, to bring superannuation funds in line with other financial institutions, SPS 510 should reflect the same prescriptive approach that applies to the other APRA regulated entities under CPS 510. We would suggest that the relationships listed be at least as prescriptive as those that apply to ASX listed companies (as set out in Box 2.3 of the Principles and Recommendations) but adapted to recognise the unique relationship between some directors of superannuation fund trustees and employer or employee groups.

We hope that our comments will be of assistance to Treasury. Please do not hesitate to contact Senior Policy Advisor, Gemma Morgan on (02) 8248 2724 if you would like to discuss.

Yours sincerely



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