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Ms Melissa Bray
Manager, Superannuation Unit
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Dear Ms Bray

Thank you for the opportunity to provide comments on the *Better regulation and governance, enhanced transparency and improved competition in superannuation* discussion paper. We are pleased that the Government is reviewing the impact of regulatory changes, particularly in light of the compliance costs associated with these changes. We believe this is an important step in ensuring that our members' interests are incorporated into any future proposals.

First State Super believes that the current equal representation model of board governance has served our members well. The equal representation model has ensured that the concerns and interests of our members and other key stakeholders have informed board decision making. First State Super welcomes the opportunity to discuss the details of strengthening good governance. We believe a governance regime that is flexible in its application is most likely to deliver improved results for fund members.

We commend the Government on seeking the industry's views on how the choice product dashboard and the portfolio holdings disclosure requirements are best satisfied. As an industry we need to ensure that the costs of increased disclosure and transparency are viewed in light of the benefits provided to fund members.

Superannuation is a pivotal sector of the economy and impacts many industries, however perhaps more importantly, for many Australians it reflects their biggest asset after the family home. It is for this reason we urge the Government to keep the members 'best interest' at the forefront when undertaking the review in this important area.

Please contact Helena Gibson on (02)92382563 if you have any questions about this submission.

Yours sincerely

Michael Dwyer AM
Chief Executive Officer
First State Super

first & foremost for you

Focus questions and First State Super responses

Part 1: A better approach to regulation

1. The Government has committed to identifying (in dollar terms) measures that offset the cost impost to business of any new regulation. What suggestion do you have for how the regulatory compliance burden can be reduced?

We support the introduction of a Regulatory Impact Assessment (RIA) as a way to assess the costs of regulatory change. However, any RIA must also consider the *benefits* that regulatory change will deliver. For example, the cost of implementing change must be measured against increased revenue to government or long-term savings to the industry, or improved outcomes for members

Our suggestions include a relaxation of the current Significant Event Notice (SEN) requirement.

We recommend that where the requirement to issue a SEN is triggered by legislative change, that the SEN information be available to members on the fund's website rather than the current requirement of being mailed to each member. This simple change could mean huge savings for larger super funds. Under the current requirements, mailing a SEN to about 800,000 members costs the fund almost one million dollars.

In addition, we recommend *annual* (1 July) updates to Product Disclosure Statements where the only material changes to occur are as a result of legislative change. Any other updates and re-prints of Product Disclosure Statements should be restricted to instances where a fund has made *material changes to the product*. Other changes should be disclosed to members via the fund's website so that the information is available to both prospective and current members.

One way to manage the cost of change is to *minimise the number of changes*. This will be best achieved if change is driven on the basis of achieving the key goals and objectives of Australia's retirement system. For this reason, we suggest the government establishes a list of 'key principles' that underpin our retirement system. This list can be used to guide the formulation of any proposed legislative change and ensure it is 'true to purpose'.

Part 2: Better Governance

2. What is the most appropriate definition of independence for directors in the context of superannuation boards?

The equal representation model has served our members well for the past 20 years. In our experience, the mix of employer and member directors has delivered a Board with the range of skills and experience required to oversee the complex operations of our Fund.

That said we consider all of our Board members to be 'independent' in the truest sense, irrespective of the method of their appointment. We can say with confidence that each of our Directors work without bias or influence and with the best interests of our members at the forefront of their decision making. Representing our employers and members demonstrably informs and strengthens our Director's decision making. It is a foundation of our Fund that we would not want to see significantly eroded.

We believe that a 'one size fits all' approach to Board composition is unlikely to deliver boards with the right mix of skill for the range of superannuation funds. For this reason we believe that a principles based approach to directors independence will deliver the best results for board governance.

We believe that the ASX Corporate Governance Principles provide a good starting point for superannuation boards. These principles would clearly need to be tailored to the superannuation environment, however, in amended format they should provide sound guidance for boards.

The ASX Principles define an independent director as being '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 judgement'. We broadly agree with this overarching principle being applied to superannuation directors.

The ASX Principles then list a series of guiding principles that may be drafted to support this definition. These will require some amendment for the superannuation environment.

The first principle that ASX boards should consider when determining a director's independence is whether the director 'is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company'. We would recommend that this guidance be modified along the lines proposed in the Cooper Review for non-associated directors. The Cooper Review defined a non-associated director as needing to be free of connections to, or associations with, employer sponsors, the appointor (other than by reason of the appointment itself), entities related to the trustee, employer groups, unions, service providers and should not be current or former executives of the fund or a related entity (Final Report of the Super System Review, Part 2 page 55). This is useful guidance for superannuation boards.

In addition, we believe that a member of the fund should be able to serve as an independent director.

We consider the following ASX Principles to be useful guidance to which superannuation boards may have regard when determining a director's independence:

- Is employed, or has previously been employed in an executive capacity by the RSE licensee or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board;

- Has within the last three years been a principal of a material professional adviser or a material consultant to the RSE licensee or another group member, or an employee materially associated with the service provided;

- Is a material supplier or customer of the RSE licensee or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer; and
- Has a material contractual relationship with the RSE licensee or another group member other than as a director.

3. What is an appropriate proportion of independent directors for superannuation boards?

We believe it is important to retain a majority of representative directors that reflect the membership of the fund, both employer and employee nominated. A flexible approach will ensure that boards strike an appropriate balance between representative and independent directors. For this reason we recommend the Government set the number of independent directors at a maximum of one-third of the superannuation board.

4. Both the ASX Principles for listed companies and APRA's requirements for banking and insurance entities either suggest or require an independent chair. Should superannuation trustee boards have independent chairs?

While historically First State Super has had an independent chair, we do not support mandating the requirement. Boards should be able to retain their current flexibility to select the best person for the role, who may or may not be classed as 'independent'.

5. Given the way that directors are currently appointed varies across funds, does it matter how independent directors are appointed?

First State Super believes it is important that appointment occurs through processes that are formal and transparent and which focus on competency and experience. We do not believe the process should be prescribed by legislation, or by APRA. Boards should retain the flexibility to adopt the most appropriate processes for their Fund.

6. Should the process adopted for appointing independent directors be aligned for all board appointments?

As stated above we recommend the process of appointing independent directors should be left to the fund and reflect the process adopted at the fund level.

7. Are there any other measures that would strengthen the conflict of interest regime?

No, we believe that the issue of 'conflicts of interests' has been adequately covered in the recent changes, specifically in APRA prudential standard SPS 521.

8. In relation to board renewal, should there be a maximum appointment term for directors? If so, what length of term is appropriate?

We support a maximum appointment term, and propose no more than 3 terms of 3 years (maximum of 9 years) as a reasonable period to ensure that a balance is achieved between experience and orderly renewal.

9. Should directors on boards be subject to regular appraisals of their performance?

As currently required in APRA prudential standard SPS 510 we believe that annual appraisals should be the standard. SPS 510 states that 'The Board must have procedures for assessing, at least annually, the Board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of individual directors.

We do not however support enshrining this requirement in further legislation.

10. Would legislation, an APRA prudential standard, industry self-regulation or a combination be most suitable for implementing changes to governance? What would the regulatory cost and compliance impacts of each option be?

We support the use of an APRA prudential standard to implement changes to governance because it will have the force of law and the flexibility to manage an appropriate transition period.

Irrespective of which option is chosen, there will be an increase in costs to secure directors with the appropriate experience and knowledge who are also deemed to be independent.

11. What is the appropriate time frame to implement the Government's governance policy under each option?

We support a three year transition period for any governance changes. This will allow funds currently complying with the equal representation requirements to make the required changes with less disruption. We believe that a rushed implementation of any reforms would trigger dangerous levels of Board instability. The sudden loss of significant corporate knowledge and the disruption of a coherant strategic direction should be avoided. Better governance should not commence with board chaos.

12. Given that there will be existing directors appointed under a variety of terms and conditions, what type of transitional rules are required?

We support a three-year transition period which will allow for existing terms to expire. With a 1 July 2014 commencement this would result in the reforms being bedded down by 1 July 2017.

Part 3A. Choice product dashboard

13. Should a choice product dashboard present the same information, in the same format as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what it should include and why?

We do not believe there should be a requirement for choice product information to be in the same format as a MySuper prescribed product dashboard.

We believe the requirement to provide this information for choice products has been developed without adequate consideration of the original purpose of the product dashboard, which was to allow for easy comparison of key features of standardised MySuper products.

Choice products by their very nature vary significantly in the way they are structured and priced and as a result, it will be difficult to adapt them to the standardised MySuper product dashboard. Further, we do not believe it will provide accurate comparisons.

We have provided answers to the following questions presuming the requirement to issue a choice product dashboard remains.

14. Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product return targets?

No, single asset sector choice products will be challenged to have an expected single benchmark related to CPI.

15. Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard?

a. If including an additional measure for a product's investment return would add unnecessary complexity
b. If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.
c. Whether it is appropriate to use a single time horizon, for example 10 years, when calculating the target net return for the range of possible choice products.

We suggest only one type of return is used and that the net return provides the most meaning to the member. Further for the sake of accurate comparability, it is imperative that there is only a single time horizon.

We acknowledge that these suggestions are being driven to accommodate the different types of choice products that exist, however using different parameters will not allow for comparability and could actually be misleading.

16. Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question you may wish to consider:

a. Is the SRM model the best measure of short-term investment risk?
b. What would be the most suitable measure of long-term risk to include on the product dashboard?
c. Is it possible to present a long-term risk measure in a similar format to the short-term risk measure (that is high/medium/low)
d. Would including an additional risk measure add complexity?

We do not support the use of the SRM model as the best measure of short-term investment risk. This is because we are concerned that the display of the number of negative investment returns expected over a 20-year period does not provide any real meaning to a member, particularly a disengaged (MySuper) member.

We suggest that the range of returns a member can expect to receive, calculated with high probability (80% confidence) is displayed. These could be shown graphically and would capture both the short-term and long-term investment risk of investing in the superannuation product.

17. Are additional carve outs from the choice product dashboards required? If so why are these additional carve outs required?

Yes, in addition to those identified in the discussion paper, it would be necessary to provide a carve out to superannuation funds that allow for individual stocks.

18. Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?

While we recognise a liquidity measure would add value to members' understanding of the riskiness of the product, we believe that it would be a difficult concept to accurately summarise into a dashboard categorisation. This is because the liquidity of an asset class in a regular investment environment may not reflect the liquidity of the asset class in abnormal conditions. We do not recommend a liquidity measure be included.

19. Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? If so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

Assuming the product dashboard goes ahead, we recommend a commencement date of 1 July 2015. We do not anticipate any additional costs as a result of the delay.

Enhanced transparency- Portfolio holdings disclosure

20. Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs? In consideration of this question you may wish to consider the various options discussed below: Should portfolio holdings disclosure be consistent with the current legislative requirements (that is full look through to the final asset, including investments held by collective investment vehicles)? Should the managers/responsible entities of collective investment vehicles be required to disclose their assets separately? To give effect to this requirement, legislation would require all collective investment vehicles to disclose their asset holdings, regardless of whether some of its units are held by a superannuation fund. Should portfolio holdings disclosure be limited to the information required to be provided to APRA under Reporting Standard SRS 532.0 Investment exposure concentrations?

We have concerns with each of the proposed models above as we do not believe they provide any meaningful information to a superannuation fund member.

The first model would provide a volume of information that would be most likely to confuse members. Further, the cost to provide this information will be high and will result in higher fees to members. Within our Fund we identified over 7,000 holdings that would be required to be disclosed (without applying the look-through requirement). It is clear there will be extreme levels of data for members to digest. Of concern also is the risk that disclosure of some unlisted investments may compromise their sale value.

An example of the complexity is in fixed income. The names of fixed interest securities are cumbersome and have no comprehensible meaning to all but a handful of institutional market participants. All the key factors which indicate the degree of risk to which the member is being exposed are not captured in a name, including things like the level of subordination, credit rating, duration and term. Furthermore, individual securities often net off against one another to change the member's economic exposure to an asset or asset class. Line by line security detail would be misleading in this case.

Similarly, the second model results in an abundance of data being provided to the member, the value of which would almost certainly be lost. This seems to be an overly onerous obligation on the entire industry.

The third model would limit the disclosure to the point that there would not be much value to the client in disclosing a handful of stocks or dissecting the information as required under this APRA Reporting Standard.

Only meaningful information should be presented to fund members. We recommend the top 50 holdings be disclosed. This top 50 would include collective investment vehicles that are controlled by the fund or an associate of the fund.

21. What would be the compliance costs associated with each of these models for portfolio holdings disclosure?

We believe that the first two proposed models would significantly increase compliance costs for funds. The third model will have minimal compliance costs however as mentioned above will not provide the member with adequate disclosure.

We believe our proposed model can be achieved without incurring significant costs.

22. Should portfolio holdings information be presented on an entity level or at a product (investment option) level?

We recommend portfolio holdings information is presented on an entity level as presentation at a product level would result in considerable additional costs.

23. Is a materiality threshold an appropriate feature of a portfolio holdings disclosure?

We support the introduction of a materiality threshold to ensure the member receives the most appropriate level of information for the least amount of cost.

24. What is the impact of a materiality threshold on systemic transparency in superannuation fund asset allocation?

We do not believe that imposing a materiality threshold will adversely impact system transparency in superannuation fund asset allocation.

25. What would be the most appropriate way to implement a materiality threshold?

The discussion paper has discussed the materiality threshold from two angles. The first is based on a nominated percentage (for example 1% in the APRA reporting standard). This means that larger funds will not have many assets to disclose, while smaller funds may have a significant number.

The second is based on selective disclosure, requiring a certain percentage of assets to be disclosed, for example 95% of the fund's assets. The issue we see with this approach is that it will still be very costly and difficult to administer and produce large amounts of information for the member.

We propose a materiality threshold that requires disclosure of the most significant holdings as stated in our response to question 20.

26. Should the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014? If so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

We recommend the commencement date be deferred until 1 July 2015. We do not expect there will be any costs as a result of the delay. However the additional time will allow funds time to develop the reporting in line with the agreed disclosures.

Part 4: Improved competition in the default superannuation market

27. Does the existing model (which commences on 1 January 2014) meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape?

Yes we believe the existing model can deliver a transparent and contestable superannuation fund system, however we do believe there may be the opportunity to simplify the process which will result in reducing the level of red tape.

28. If not, is the model presented by the Productivity Commission the most appropriate one for governing the selection and ongoing assessment of default superannuation funds in modern awards or should MySuper authorization alone be sufficient?

We support a model which ensures that the best interests of members are at the centre of the model. The MySuper regime ensures a member who is not engaged with their super is invested securely in a product that is low-cost, administratively efficient and without conflict. Further, we support a model that encourages a level playing field.

We have concerns that the process of default fund selection could be overwhelming for some employers and that any relaxation of the current requirements may open the way to 'third line forcing'.

29. If the Productivity Commission's model is appropriate, which organisation is best placed to assess superannuation funds using a 'quality filter'. For example should this be done by an expert panel in the Fair Work Commission or is there another more suitable process?

We propose that APRA be considered as an alternative organisation to apply the quality filter. While this could be considered a bold suggestion we believe there may be efficiencies to be achieved by allowing APRA to leverage off information they have already collected as part of the MySuper application process, thereby reducing the amount of red tape involved in the process.

Further, we believe that in their role as regulator of the superannuation industry, APRA have a unique insight into the governance practices and administrative efficiency of funds, an insight that cannot be seen on an application form.

30. Would a model where modern awards allow employers to choose to make contributions to any fund offering a MySuper product, but an advisory list of high quality funds is also published to assist them in their choice, improve competition in the default superannuation market while still helping employers to make a choice?

In this model, the advisory list of high quality funds could be chosen by the same organisation referred to in question 29.

We agree that an advisory list of high quality funds would be useful to help employers make a selection.

31. If changes are made to the selection and assessment of default superannuation funds in modern awards, how should corporate funds be treated?

We do not believe that corporate funds should be treated any differently as a result of the proposed changes.