LGsuper

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Superannuation Unit
Financial Services Division
The Treasury
PARKES ACT 2600

"Better regulation and governance, enhanced transparency and improved competition in superannuation."

The Queensland Local Government Superannuation Board (the Board) as trustee for the Local Government Superannuation Scheme (LGsuper) welcomes the opportunity to provide feedback and comments on the proposals outlined in the above Discussion Paper.

LGsuper

The Board is constituted under the Local Government Act 2009 (Qld) to act as trustee for LGsuper, a public sector superannuation fund. LGsuper provides coverage for all employees in Queensland local government and currently comprises 87,000 members and approx. $8.0b in FUM.

The Board currently comprises 4 member-elected representative directors, 4 employer representative directors and 4 independent directors. By 31 December 2014 the Board will transition to 3 member-elected representative directors, 3 employer representative directors and 3 independent directors.

Prior to 1 December 2013 the Board only had one independent director, Mr Brian Roebig OAM, who is the Chairman of the Board. On 1 December 2013, 3 new independent directors were appointed by the Board to make what was already a well-functioning board even better. The changes were designed to bring greater balance, leadership and diversity to its structure as the Board broadens its combined skills, knowledge and experience.

Comments on the Discussion Paper

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 suggestions do you have for how the regulatory compliance burden can be reduced?*

The Board recognises that an industry which benefits from compulsory savings and tax advantages should be faced with an appropriate level of regulatory compliance to ensure benefits envisioned by Government policy are actually received by the Australian people. Where there will always be disagreement is the definition of 'appropriate level of regulatory compliance'.

The Board supports a rigorous Regulatory Impact Assessment process for new regulation. It considers that the consultation process should be used to identify the costs to industry of any new regulation. These costs should then be compared to the identified benefits expected to be derived from the proposed new regulation. Regulatory agencies which propose new regulations should be required to identify and quantify the benefits to be achieved by their proposals to facilitate the impact assessment.

Using a rigorous process would be expected to ensure any 'wish-list' proposals for regulatory changes from Regulators are subjected to disciplined procedures and assessment.

Part 2: Better Governance:

What should 'independent' mean for superannuation fund trustees and directors?

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

The Board notes the comments of the Queensland State Manager of AICD in the February 2014 edition of *QLDdirector* wherein he states:

"...It is accepted that a good director should display independence of mind and judgement rather than meeting a strict set of requirements that determines independence....Conflicting interests must be avoided. This can be managed via various rules in the Corporations Law...If managed well, such interests need not exclude the right person from taking on a directorship in a company that will benefit from their expertise."

The Board considers the following factors could be included in any new definition of independent directors but care should be exercised that specificity in law may deny a fund's members from having the best possible board to manage their retirement savings:

- Whether the director is or has been employed in an executive capacity by the RSE licensee or any of its related entities in the previous five years.
- Whether the director, or a related entity of the director, is a substantial shareholder (>5%) of the RSE licensee or any of its related entities.
- Whether the director holds, or has held in the last three years, a senior role in a professional advisor, consultant or service provider to the RSE licensee.
- Whether the director is employed by or acts as a representative of a trade union or other organisation representing the interests of members of the fund.
- Whether the director is employed by or acts as a representative of an employer that makes contributions into the fund or is employed by or acts as a representative of an organisation representing the interests of such employers.

It should be noted that the above factors reflect an extension of the concept of independence applicable to listed companies, ADI's and insurance companies by including independence from super fund stakeholders being participating employers and members and their representatives.

The Board does not consider that an independent director should be precluded from becoming a member of a fund managed by the RSE licensee as is currently required by SIS s89. The Board considers that all directors should be able to be members of a fund to provide further incentive to act as a fiduciary of the fund.

Proportion and role of independent directors

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

The Board supports the continuation of the role of representative directors on the boards of RSE licensees. Representative directors provide a stakeholder perspective to a board and can better represent the opinions and requirements of the stakeholders.

The Board considers that a board of an RSE licensee should have one third of its number being independent directors, assuming the other two thirds are split equally between employer and member representatives. (A board of an RSE licensee which does not have representative directors should have a majority of independent directors.)

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?*

The Board acknowledges that the key role of the Chairman is to be responsible for leadership of a board and for the efficient organisation and conduct of the board. Where the chair is an independent director, it would allow a board to look for the characteristics of a good chair in prospective candidates for an independent director position. This selection process is not necessarily available with the appointment of representative directors.

However, the Board does consider that the characteristics of a good chair could equally be present in a representative director and they should not be disqualified from holding the position by an inflexible regulatory requirement.

Process for appointing directors on superannuation trustee boards

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

The method of appointment of independent directors should be left to up to the board to determine.

The LGsuper Board in appointing its independent directors:

- determined the skills and experience required of independent directors,
- sought nominations from its existing Board members,
- interviewed all nominees, and
- passed a resolution appointing the preferred nominees.

This procedure worked well for the Board given the high quality of nominations considered and the willingness of all directors to be involved in the appointment process. Other boards may require the assistance of a recruitment agency to identify suitable candidates, the use of a nominations sub-committee of the board to identify the preferred candidate, or, may wish to include stakeholders in the nomination process. It is considered that boards should have the flexibility to determine the selection process which suits their own circumstances.

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

Given that the Board supports the continuation of the representative board, it does not consider that the process for the appointment of independent directors should also be applied to representative directors. The Board's representative directors are currently appointed by election (for member representatives) and by nomination by stakeholder bodies (for employer representatives).

These processes work well for the different types of directors being appointed. It is considered that there would be significant problems in applying one of them to all the types of directors eg election of employer representatives by the members would not necessarily provide the Board with appropriate representation of its employer stakeholders.

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

The current requirements are adequate.

Ongoing effectiveness of superannuation trustee boards

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

The Board considers that if maximum terms are necessary then three terms of appointment should be an appropriate maximum. The Board's representative directors currently have four year terms with similar terms for independent directors subject to achieving a reasonable staggering of appointments to minimise board turnover at any point in time. This would provide a maximum appointment period for directors of 12 years.

Some flexibility should be allowed (eg a two year extension) if there has been substantial turnover on a board during a particular period to ensure the loss of board knowledge is minimised. APRA could be used to review such extensions to ensure the flexibility is not subject to abuse by some Boards.

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

As part of their leadership role the chair should be engaged in continuous appraisals of the performance of the board and individual directors. Where improvement is required the chair should negotiate appropriate development activities for the director.

The Board's experience with external assessments of its performance has been less than satisfactory especially given the cost and time allocated by the Board to the exercise.

Implementation issues

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?*

The Board considers that high level principle statements should be included in a prudential standard with any detailed requirements confined to a prudential practice guide (PPG). PPG's provide guidance to RSE licensees on the basis that if a trustee does not follow the guidance they should explain why not. This is consistent with the ASX Principles which are issued on an "if not why not" basis. They allow boards to vary their practices from the ASX Principles provided boards justify such variations.

Placing detailed requirements in legislation is prescriptive and lacks flexibility. It would be difficult to provide for all the different variations in boards within the industry and substantial funds would need to be invested by trustees, at a cost to their fund members, to vary their existing constitutions.

Industry self-regulation would be difficult given the different factions within the industry, especially the retail and not for profit segments, having to agree on the various requirements.

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

In considering transition periods the Government needs to be mindful of the greater demand for independent directors from a limited pool of quality and experienced directors and the impact on board functions from a reduction in the level of corporate knowledge on boards due to losses of experienced directors within a short timeframe.

It is considered that implementation of a policy to require funds to have an independent director as Chair of the board would require a transition period of at least 2 years.

Implementation of policies such as maximum appointment terms would need to take into consideration existing directors' appointments and the implications for boards of how many existing directors would be required to cease their appointments. It is suggested that a transition period of a minimum of 3 years would be necessary.

Implementation of a requirement for one third of a board being independent directors would need to consider the difficulty of appointing a number of skilled and experienced independent directors when there is high demand from many funds due to the new requirement. Implementation of the requirement may also cause some funds to reduce the number of representative directors in order to minimise the increase in board numbers and cost of directors' fees. A transition period of 5 years should be adequate here.

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

Some thoughts on this issue include:

- Some directors previously appointed as representative directors may actually qualify under new rules as independents. Transition rules could be set to either disregard their claim to be an independent director because they have been previously appointed as a representative director, or, if their connection to employers or members prior to their current appointment was tenuous then they could be transitioned as an independent director.

- Given the limited talent pool for independent directors the Government may wish to allow some flexibility around the definition of independent directors to allow some persons who may be disqualified by the definition to qualify for a limited period. For example, if the definition disqualified former staff of the RSE licensee or former staff of service providers who had not had a period of separation of at least the defined term, a transitional arrangement could allow that term to be reduced for a limited time.

Part 3: Enhanced transparency—choice product dashboard and portfolio holdings disclosure

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 should it include and why?*

Choice products are different to MySuper products as they can comprise a wide variety of products which will cause complications to the dashboard concept. Firstly, while a number of choice products are pre-mixed, multi asset class products (eg high growth, growth, balanced, etc) for which a CPI+ objective (real return target) is relevant, many of the products are single asset class products (eg Aust shares, property, cash) or even single asset products (eg BHP shares, CBA shares, 10 year govt bonds) for which a CPI+ objective is not relevant and is not used. The asset class products normally have an asset index as their objective while single asset products probably don't have an objective.

The current dashboard uses a real return target for MySuper products. Choice products will require return targets based on indices for asset class products which will be more volatile and potentially less comparable between funds.

It is considered that product dashboards are not relevant for single asset products and it is questionable whether they are relevant for single asset class products.

Net investment return versus net return.

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

No, please see above.

Questions 15 to 19 – no response proposed.

Part 3B. Portfolio holdings disclosure

Presentation of portfolio holdings

20. *Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs? In considering this question, you may wish to consider the various options discussed above:*

    - *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?*

The Board proposes that only investment holdings greater than 5% of FUM and/or the top 20 holdings in each asset class be disclosed.

Questions 21 to 26 – no response proposed.

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?*

In the Board's submission to the Productivity Commission it argued that the success of the previous system had been dismissed too easily by the Commission. While the Board acknowledges that the new system should meet the objectives for a fully transparent and contestable default fund system for awards, it does not consider that selections will be achieved with a minimum of red tape. With over 110 MySuper products now approved by APRA the selection process is expected to become convoluted, bureaucratic and expensive both for the Federal Government and super funds. With an outcome of producing a 'shortlist' of higher quality default funds, employers will still be faced with choosing a fund from a list of up to 15 funds. The Board does not see how this is an improved system given the extended process involved in getting to the list and the expected subjectivity involved in the final decision. Does this really produce an improved result for employers and, in the end, the retirement savings of default members?

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 authorisation alone be sufficient?*

The Board continues to support the previous system of selection of default funds by the industrial parties to an award. This system can be enhanced by the provision of the 'quality factors', which were going to be used by the expert panel, to the industrial parties to prepare their recommended list for consideration by the FWC prior to insertion in the award. This system is less bureaucratic, reduces costs by allocating the selection decision to the industrial parties, but still provides more discipline through application of the quality factors to the selection process.

The Board considers that MySuper authorisation by itself could be adequate to determine default funds for awards. Modern awards would be simplified by only requiring the default funds to be

selected by employers as having to be an authorised MySuper product. There would be no need for a bureaucratic process for default fund selection and MySuper products which lose their authorisation would automatically lose their ability to act as a default fund which means there is no ongoing assessment process required.

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?*

As indicated above, the industrial parties to each award could utilise the quality filters in developing their recommended default funds for consideration by the FWC. There would be substantial cost savings to the Government by using this option

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 focus question 29.*

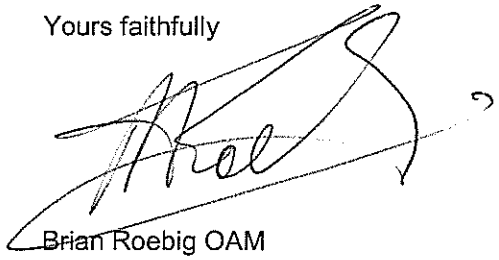
This approach would appear to generate competition in the default superannuation market, but the Board does not believe that it would help employers making a choice. They would still have to select from a list of 15 or more funds which would prove difficult for employers especially small employers.

It would also require all superannuation funds to increase their marketing budgets to market themselves broadly to their target memberships which means increased costs to members.

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

The Board considers that if corporate funds wish to become a default fund then provided they have an authorised MySuper product, they should be able to be assessed through the quality filter and be available to be a default fund under a modern award.

Yours faithfully



Brian Roebig OAM
Chairman

12 February 2014.