

# Chapter 2

## Views on proposed changes

### Introduction

2.1 Superannuation is now the second largest asset held by Australians after the family home, with the significance of superannuation for Australian households set to increase over time.<sup>1</sup> Currently, employers are required to make minimum payments to complying superannuation funds at the rate of 9.5 per cent of salary and wages to build employees' retirement savings. This contribution rate is scheduled to rise to 12 per cent by 1 July 2025.<sup>2</sup> Superannuation accounts for around 27 per cent of Australian household net wealth.<sup>3</sup>

2.2 As at 30 June 2015, there was over \$2 trillion invested by superannuation funds on behalf of their members. Approximately one-third of this is held in self-managed superannuation funds, with the remaining held by not-for-profit funds (industry funds, corporate funds and public sector funds) and the retail (for-profit) funds.<sup>4</sup>

2.3 This chapter will examine the main aspects and effects of the bill, and set out concerns raised by submitters and witnesses, with regard to:

- how independent directors could be drawn from a wider pool, increasing diversity;
- the definition of 'independent';
- independent governance, including concerns about dismantling the equal representation model of governance;
- the role of APRA to determine independence;
- the transition period provided by the bill; and
- the potential for mergers and acquisitions.

2.4 During his second reading speech, the then Assistant Treasurer, the Hon Mr Josh Frydenberg MP, noted that employees contributing to superannuation funds rely on the good governance of those funds, which necessitates a very high standard of governance:

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1 Hon Josh Frydenberg MP, Assistant Treasurer, *House of Representatives Hansard*, 16 September 2015, p. 16.

2 Hon Josh Frydenberg MP, Assistant Treasurer, *House of Representatives Hansard*, 16 September 2015, p. 16.

3 Ms Vicki Wilkinson, Chief Adviser, Financial System and Services Division, Department of the Treasury, *Committee Hansard*, 28 October 2015, p. 31.

4 Swoboda, Kai, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015', *Bills Digest*, p. 9.

Employees cannot generally access their superannuation until they retire and they rely on others to manage their superannuation until that time. The government wants to make sure that superannuation is managed with the highest possible standards of governance, in a way that is in superannuation members' best interests. This, fundamentally, is what this bill seeks to bring about.<sup>5</sup>

2.5 The Treasury submitted that there are significant benefits associated with independent governance:

Independent directors bring to the board an external, dispassionate perspective, enabling boards to benefit from a diversity of views and providing a check on management recommendations. In contrast to directors who may be executives of the RSE licensee's business or who represent employers or employees, independent directors are more likely to be free of the types of conflicts that may cause them to (either intentionally or unintentionally) serve the interests of the employer sponsors, a related party or a subset of members, rather than the fund's entire membership.<sup>6</sup>

2.6 The Treasury suggested that accountability and transparency would be increased through strengthening oversight of management of superannuation funds by independent directors.<sup>7</sup>

2.7 Representatives of the Treasury told the committee at its public hearing in Melbourne that current governance arrangements were out-dated, and that, because of industry change, the governance model was no longer effective:

The superannuation landscape has evolved significantly since the introduction of the Superannuation Industry (Supervision) Act in 1993. Superannuation funds are now complex financial businesses, and trustees have to manage an ever-growing pool of Australian retirement savings.<sup>8</sup>

2.8 The committee notes the views of APRA, which is in strong support of independent board appointments to trustee boards. This view was set out in a speech to the AIST Governance Ideas Exchange Forum in Melbourne on 20 October 2015, by APRA Member, Mrs Helen Rowell:

APRA's long-held view is that independent directors play a very important, positive role on boards – not just in superannuation but across all APRA-regulated industries. APRA's experience, over many years and across all our industries, is that having at least some independent directors on boards supports sound governance outcomes. Independent directors broaden the skills and capabilities that can be brought to the board table, and improve

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5 Hon Josh Frydenberg MP, Assistant Treasurer, *House of Representatives Hansard*, 16 September 2015, p. 16.

6 Department of the Treasury, *Submission 21*, p. 1.

7 Department of the Treasury, *Submission 21*, p. 1.

8 Ms Vicki Wilkinson, Chief Adviser, Financial System and Services Division, Department of the Treasury, *Committee Hansard*, 28 October 2015, p. 31.

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decision-making by bringing an objective perspective to issues the board considers. They are also well placed to hold other directors accountable for their conduct, particularly in relation to conflicts of interest. As outlined in our submissions to the Financial System Inquiry, we consider the diversity of views and experience that independent directors bring supports more robust decision-making by boards.<sup>9</sup>

### **Increasing diversity and flexibility on boards**

2.9 The committee heard that an important aspect of the proposed changes to the number of independent directors is the greater pool from which independent directors will be drawn, should the bill be passed. The Explanatory Memorandum to the bill states:

Increasing independence can also be seen to bring diversity in worldview to a board's decision making processes. A diverse worldview enables the decision making processes of superannuation boards to be tested and challenged in a way that achieves beneficial member outcomes and feeds back into the above covenants.<sup>10</sup>

2.10 Ms Vicki Wilkinson, Chief Adviser, Financial System and Services Division, the Treasury, told the committee that independence would give flexibility to boards to select directors with appropriate skillsets:

Good trustee governance is fundamental to enhancing members' retirement incomes. This view was also supported in the 2014 financial system inquiry, when it stated that, as more fund members exercise choice, directors appointed by employer and employee groups are less likely to represent the broader membership of public offer funds and, given the diversity of fund membership, it is more important for directors to be independent, skilled and accountable than representative.<sup>11</sup>

2.11 Submitters and witnesses highlighted the potential of independence to increase diversity on boards. Professor Thomas Clarke, Director, UTS Centre for Corporate Governance, told the committee that independent directors would increase diversity:

There is a serious problem in the culture of the boards of Australia and that is the tiny gene pool from which the directors are recruited...We have to change that. We need greater diversity, competence, ability and

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9 Mrs Helen Rowell, *Governing Superannuation in 2015 and beyond: Facts, Fallacies and the Future*, *Speech to the AIST Governance Ideas Exchange Forum*, 20 October 2015, <http://www.apra.gov.au/Speeches/Pages/Governing-Superannuation-in-2015-and-beyond.aspx> (accessed 3 November 2015).

10 Explanatory Memorandum, p. 35.

11 Ms Vicki Wilkinson, Chief Adviser, Financial System and Services Division, Department of the Treasury, *Committee Hansard*, 28 October 2015, p. 31.

demography on our boards for them to perform better. That is a broad problem with governance in this country and probably in others too.<sup>12</sup>

2.12 Mr Alan Kirkland, Chief Executive Officer of CHOICE, told the committee that 'diversity is an outcome of allowing more independence':

It allows a board to tap into a broader pool of applicants, it encourages a board to think about the particular skillsets or attributes it wants in directors and you are likely to see more diversity as a result. The main reason to have more independence is to create the best possible chance that you have for people on the board who are very strongly focused on the best outcomes for the entity and therefore for its members and also to make sure they have the right mix of skills that would allow you to achieve that.<sup>13</sup>

2.13 Representatives of the Governance Institute of Australia expressed the view that independent directors would minimise risk by drawing on a larger pool of decision-makers, with particular regard to gender, age and experience.<sup>14</sup>

2.14 Similarly, Ms Sally Loane, Chief Executive Officer of the Financial Services Council (FSC), told the committee that independent directors would provide a 'crucial protection mechanism against conflicted decisions which can lead to poor consumer outcomes'.<sup>15</sup>

2.15 However, Ms Melina Morrison, Chief Executive Officer of the Business Council of Co-operatives and Mutuals, noted that although they agree that there is a need for diversity on boards, they disagreed that the changes set out by the bill would affect the desired change.<sup>16</sup>

### **The definition of independent**

2.16 The bill seeks to define 'independent' in proposed new section 87, which sets out the definition of independent from an RSE licensee, for the purpose of meeting the requirements of the bill. A person would be independent unless certain conditions are present, such as:

- if the RSE licensee is a body corporate that has a share capital or shareholding interest in five per cent or more of the share capital of the RSE licensee or a body corporate that is related to the RSE licensee;

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12 Professor Thomas Clarke, UTS Centre for Corporate Governance, *Committee Hansard*, 23 October 2015, p. 8.

13 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 23 October 2015, p. 31.

14 Mr Steven Burrell, Chief Executive Officer, Governance Institute of Australia, *Committee Hansard*, 23 October 2015, p. 14, p. 17.

15 Ms Sally Loane, Chief Executive Officer of the Financial Services Council, *Committee Hansard*, 23 October 2015, p. 47.

16 Ms Melina Morrison, Chief Executive Officer of the Business Council of Co-operatives and Mutuals, *Committee Hansard*, 23 October 2015, p. 24.

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- if the RSE licensee has been an executive officer (other than director) or employee of the RSE licensee or a related RSE licensee;
  - if the RSE licensee has had a business relationship with the RSE licensee or any individual trustees; and
  - if the RSE licensee is a trustee of a regulated superannuation fund, is, or has been, a director or executive officer of a large employer in relation to the fund.

2.17 Some submitters raised concerns about the proposed definition of independent for the purpose of meeting the requirements of the bill. For example, the Governance Institute of Australia suggested that legislation should 'set out the principle of independence, but not prescribe a definition'.<sup>17</sup>

2.18 A report on governance of superannuation funds, published by Mercer Consulting, also proposed a 'principles-based' definition which would 'enhance objectivity and impartiality, but which would allow an independent director to be a fund member'.<sup>18</sup>

2.19 The Australian Institute of Company Directors suggested that the definition of independent could be broader, modelled on Principle 2 under the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (Principles and Recommendations):

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.<sup>19</sup>

2.20 The Australian Industry Group (AI Group) submitted that although they supported the principles of the bill, they held concerns about the definition of independent, which they characterised as 'overly restrictive'.<sup>20</sup>

### **Independent governance**

2.21 The bill, if passed, would introduce the requirement that one third of directors on boards of APRA regulated superannuation funds be independent from the RSE licensee.

2.22 The committee heard a mixed response to the requirement for one third of directors to be independent. Although some submitters and witnesses supported the proposition, other submitters consider that the bill does not go far enough and argued for a majority of independent directors. Some submitters and witnesses did not support the changes.

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17 Governance Institute of Australia, *Submission 19*, p. 1.

18 Mercer Consulting, *Submission 4*, p. 4.

19 Australian Institute of Company Directors, *Submission 17*, p. 1.

20 AI Group, *Submission 15*, p. 3.

2.23 The Association of Superannuation Funds of Australia (ASFA) and National Seniors support the requirement of the bill that one third of directors be independent.<sup>21</sup>

2.24 The Governance Institute of Australia submitted that the requirement for one third of directors to be independent was a good start, but that their preference was for the majority of directors to be independent. They submitted that majority independence was the prevailing international standard, and that 'retirement schemes in developed countries are moving towards appointing more independent directors'.<sup>22</sup>

2.25 Similarly, the FSC told the committee that the bill would see 'moderate change', noting that the majority of their members supported a majority of independent directors.<sup>23</sup>

### **APRA**

2.26 APRA submitted that their present powers to address governance-related concerns are limited.<sup>24</sup> Currently, section 29EB of the SIS Act provides that APRA may direct an RSE licensee to comply with the SIS Act, SIS Regulations and prudential standards, but only after the RSE licensee has contravened the law.<sup>25</sup>

2.27 The bill, if passed, would provide APRA with the power to determine that a person is independent from an RSE licensee,<sup>26</sup> and also to determine that a person is not independent.<sup>27</sup> Proposed new sections 88 and 90 provide for APRA to make determinations about whether a director is able to exercise independent judgement. They submitted that:

[t]his mechanism is necessary to ensure that there is certainty where an individual might have a non-typical relationship with an RSE licensee such that it is unclear whether the individual is 'independent'. It reflects the practical reality that it is not possible to clearly address in the legislation all situations that may arise in practice; it is essential that APRA be able to respond to unusual circumstances to provide the necessary certainty to industry.<sup>28</sup>

2.28 CHOICE submitted that the proposed power to allow APRA to determine independence may not be necessary, and suggested an alternative option where APRA be referred a question of independence for guidance but that the final decision rest

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21 ASFA, *Submission 14*, p. 1; National Seniors, *Submission 20*.

22 Governance Institute of Australia, *Submission 19*, p. 3.

23 Mr Andrew Bragg, Director of Policy, Financial Services Council, *Committee Hansard*, 23 October 2015, p. 49.

24 APRA, *Submission 10*, p. 8.

25 APRA, *Submission 10*, p. 8.

26 Proposed new section 88.

27 Proposed new section 90.

28 APRA, *Submission 10*, p. 8.

with the referring body.<sup>29</sup> CHOICE submitted that regulations that currently apply to deposit-taking, general insurance and life insurance industries provide a relevant precedent.<sup>30</sup> National Seniors supported CHOICE's proposal, stating:

There is no precedent in any other APRA-regulated sector where APRA decides on the independence of directors. National Seniors believes that APRA's powers for regulated superannuation funds should be consistent with the powers it has for regulating entities in the deposit-taking, general insurance, life insurance and private health insurance industries. APRA is regarded as having been effective in this area and we would take some confidence from a role consistent with their existing approach.

Superannuation fund boards should be responsible for deciding on the independence of directors.<sup>31</sup>

2.29 The Centre for Workforce Futures expressed the view that giving APRA the role of determining independence may restrict the available pool of candidates.<sup>32</sup>

2.30 The AIST opposes APRA having the power to determine independence,<sup>33</sup> as does Industry Super Australia<sup>34</sup> and Mr Phillip Sweeney.<sup>35</sup>

2.31 Noting that concerns have been raised about APRA's role in determining independence, APRA stated that it expects to use this power infrequently, '...as the legislative definition of independence should provide sufficient information to undertake a robust assessment of a director's independence in most circumstances.'<sup>36</sup>

2.32 APRA advised the committee that the supporting guidance to RSE licensees had been updated to reflect the proposed changes and is currently out for public consultation, and 'encourages RSE licensees to refer the matter to APRA for guidance where they may be in doubt about a director's independence.'<sup>37</sup>

2.33 The committee notes that any decision that APRA makes using the powers in either proposed section 88 or section 90 is a reviewable decision within the meaning given in the SIS Act.<sup>38</sup>

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29 CHOICE, *Submission 8*, p. 3.

30 CHOICE, *Submission 8*, p. 3. See also, *Committee Hansard*, Friday 23 October 2015, p. 27.

31 National Seniors, *Submission 20*, p. 2.

32 Centre for Workforce Futures, *Submission 2*, p. 16.

33 Australian Institute of Superannuation Trustees, *Submission 7*, p. 5.

34 Industry Super Australia, *Submission 12*, p. 8.

35 Mr Phillip Sweeney, *Submission 23*, p. 7.

36 APRA, *Submission 10*, pp 8-9.

37 APRA, *Submission 10*, p. 9.

38 APRA, *Submission 10*, p. 9.

2.34 The Australian Chamber of Commerce and Industry, while noting that these powers seem unusual, advised the committee that they appear to be justified on the basis that decisions made under these proposed provisions are reviewable.<sup>39</sup>

### ***Equal representation***

2.35 Part 9 of the SIS Act enshrines equal representation of member and employer representatives on boards of non-public offer holding RSE licensees. Equal representation was a significant pillar of the introduction of compulsory superannuation in 1993.

2.36 The Financial Services Inquiry (FSI), conducted in 2014, found that the equal representation model was no longer a truly representative model, as superannuation funds are less focussed on a single employer than when superannuation was introduced. The FSI argued that 'directors appointed by employer and employee groups are less likely to represent the broader membership of public offer funds', and that '[g]iven the diversity of fund membership, it is more important for directors to be independent, skilled and accountable than representative'.<sup>40</sup>

2.37 Similarly, Ms Wilkinson, from the Treasury, told the committee that although the equal representation model had been appropriate in 1993, when superannuation was made compulsory, it had lost its utility.<sup>41</sup> The Treasury noted the Cooper Review, which found that industry change had lessened the need for equal representation. The Treasury submitted that the equal representation model was now detrimental to governance:

The current equal representation model in the Superannuation Industry (Supervision) Act 1993 (SIS Act) hinders the natural refreshing of boards because of the restrictions on the number of independent directors that can be appointed to some registrable superannuation entity (RSE) licensee boards.<sup>42</sup>

2.38 Some submitters and witnesses expressed concern that the equal representation model would be replaced. For example, the Centre for Workforce Futures at Macquarie University submitted that the equal representation model had been a successful one:

Diversity of views, skills and experience is touted in the explanatory memorandum as one of the key benefits of increasing the number of independent directors. However, greater diversity seems strongly associated with the structure of the equal representation model, which limits excessive

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39 Australian Chamber of Commerce and Industry, *Submission 13*, p. 9.

40 Financial Services Inquiry, *Governance of superannuation funds*, <http://fsi.gov.au/publications/final-report/chapter-2/super-governance/> (accessed 27 October 2015).

41 Ms Vicki Wilkinson, Chief Adviser, Financial System and Services Division, Department of the Treasury, *Committee Hansard*, 28 October 2015, p. 31.

42 Department of the Treasury, *Submission 21*, p. 1.



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appointment of individuals from one particular group of 'insiders' and prescribes minimum numbers of appointees from different backgrounds. Accordingly, using independence to minimise potential conflicts of interest is likely to result in little meaningful improvement in this regard.<sup>43</sup>

2.39 Mr Tom Garcia, Chief Executive Officer of the Australian Institute of Superannuation Trustees (AIST) told the committee that although AIST does not oppose the appointment of independent directors, they do oppose the repeal of equal representation. Mr Garcia expressed the view that equal representation could be retained alongside independence:

We contend that having independence on boards and having equal representation are not mutually exclusive. The stated objectives of this legislation are to broaden each board's pool of experience and to increase the accountability of decisions made by directors, particularly in relation to conflicts of interest. If these are the true aims of the legislation, they could best be achieved in other ways.<sup>44</sup>

2.40 Similarly, Mr Alan Kirkland, Chief Executive Office of CHOICE, told the committee that although they support the introduction of independent directors, the changes set out by the bill were significant:

[t]his bill takes quite a big step in repealing part 9 of the act and, in doing so, removing the definition of a member representative and employer representative as well as the basic equal representation rule, which seems like a very big change in the context of the overall aim of this bill.<sup>45</sup>

2.41 Representatives of the ACTU told the committee that the equal representation model was successful in fostering consensus in board decisions.<sup>46</sup> Further, the ACTU told the committee that change was not needed while the system was successful:

We are deeply concerned that we have a proposal before us where the government wants to impose a model on a system that is working so well and is so successful, and they are saying they may want to mandate that all funds should have a third of their directors as independents. We are concerned that that will significantly alter the culture.<sup>47</sup>

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43 Centre for Workforce Futures, Macquarie University, *Submission 2*, p. 4.

44 Mr Tom Garcia, Chief Executive Officer, Australian Institute of Superannuation Trustees, *Committee Hansard*, 28 October 2015, p. 8.

45 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 23 October 2015, p. 27.

46 Mr David Oliver, Secretary, Australian Council of Trade Unions, *Committee Hansard*, 28 October 2015, p. 2.

47 Mr David Oliver, Secretary, Australian Council of Trade Unions, *Committee Hansard*, 28 October 2015, p. 2.

2.42 APRA and the Treasury noted that the equal representation model could continue under the amendment, but in a modified form, taking into account the requirement for one third independent directors.<sup>48</sup>

### ***Independent chair***

2.43 Under proposed new section 86 of the bill, the chair of the RSE licensee's board of directors will be required to be independent from the RSE licensee.

2.44 The Treasury noted that during the consultation process on the exposure draft, some superannuation funds had expressed concerns over the requirement of the bill that the chair of a board of directors be independent. According to the Treasury, these concerns are addressed by the transition period provided by the bill, as the independent chair will not have to be appointed until the end of a three year transition period.<sup>49</sup>

2.45 Support for this provision was expressed by the Association of Superannuation Funds of Australia (ASFA), who submitted that the recommendation to have an independent chair 'is consistent with contemporary governance standards and with requirements of other prudentially regulated entities, including banks and insurance companies'.<sup>50</sup> Further, that the role of the chair in providing guidance was central to the performance of the fund:

The importance of the role played by the chair in ensuring the effectiveness of a trustee board cannot be overstated. This role includes guiding the board and CEO to focus on the right strategic priorities, make difficult decisions and ensure all fiduciary duties are met. The trustee board should therefore consider the characteristics it seeks in a chair and devise suitable procedures for the chair's appointment.<sup>51</sup>

2.46 Some submitters expressed concerns over the provision of the bill which would ensure an independent chair. These submitters include: National Seniors, Corporate Superannuation Association and Industry Super Australia.<sup>52</sup>

### ***Transition period***

2.47 The bill includes provision in Part 3 of Schedule 1 for a three year transition period. The Explanatory Memorandum to the bill states:

Existing RSE licensees that comply with transition requirements set out in APRA's prudential standards will not have to comply with the new arrangements until the end of a three year transition period, which will

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48 APRA, *Submission 10*, p. 8; Department of the Treasury, *Submission 21*, p. 3.

49 Department of the Treasury, *Submission 21*, p. 9.

50 ASFA, *Submission 14*, p. 9.

51 ASFA, *Submission 14*, p. 9.

52 National Seniors, *Submission 20*; Corporate Superannuation Association, *Submission 5*; Industry Super Australia, *Submission 12*.

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commence from Royal Assent. The purpose of the transition period and APRA's prudential standards relating to transition is to facilitate an orderly transition to the new arrangements.<sup>53</sup>

2.48 During the transition period, item 25 provides that the transitional prudential standards will override any contradictory provisions in trust deeds and other rules governing a regulated superannuation fund, including the constitution of a corporate trustee. This provision replicates the provision in the new section 93B in schedule 1, Part 1, item 1. This provision is required during the transition period to allow RSE licensees time to amend their trust deeds or constitutions because new section 93B will not take effect until the end of the transition period.<sup>54</sup>

2.49 As APRA has prudential oversight of the superannuation system, the SIS Act allows APRA to issue prudential standards relating to superannuation. Prudential standards are designed to provide additional detail on prudential matters set out in the enabling legislation. Prudential standards are legislative instruments, disallowable in the Senate, and require industry consultation as part of their development and ongoing revision.<sup>55</sup>

2.50 ASFA supports the proposed three year transition period, and recommends that it begin on 1 July 2016.<sup>56</sup> The Australian Chamber of Commerce and Industry also supports the three year transition period.<sup>57</sup>

2.51 The Treasury submitted that during their consultation process, most stakeholders had expressed support for a three year transition period, but noted that some stakeholders had a preference for the three year transition period to commence on 1 July 2016 rather than on Royal Assent.<sup>58</sup>

2.52 Unisuper suggested that the requirement for an independent committee chair could be phased in over a longer period. This is on the basis that it would allow '...newly appointed independent directors to develop expertise in and familiarity with the trustee before taking on these additional and significant responsibilities as committee chairs.'<sup>59</sup>

2.53 AIST suggested that the three year transition period is inadequate and proposed a five year transition period:

This period appears to have been chosen to align with director terms under board renewal policies. AIST has found however that a significant number

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53 Explanatory Memorandum, p. 11.

54 Explanatory Memorandum, p. 28.

55 Explanatory Memorandum, p. 9.

56 ASFA, *Submission 14*, p. 15.

57 Australian Chamber of Commerce and Industry, *Submission 13*, p. 6.

58 Department of the Treasury, *Submission 21*, p. 4.

59 Unisuper, *Submission 6*, p. 2.

of its member funds have four-year terms (in some cases five-year terms), and the proposed transition period may therefore not allow them sufficient opportunity to rotate existing directors in a manner that protects the best interests of members or that complies with existing contractual arrangements.<sup>60</sup>

2.54 AIST further suggests that as the bill, if passed, will potentially cause turnover of up to one third of trustee-directors, a longer transitional period is needed to deal with the risks presented by such a significant turnover.<sup>61</sup>

2.55 Industry Super Australia opposes the three year transition period, stating that:

...boards will have to prioritise compliance with the new law over other competing demands related to board renewal and continuity. Meeting the new obligations is certain to disrupt existing renewal and succession plans. Plans to fill gaps in skills or experience may be abandoned in favour of meeting the demands of the legislation.<sup>62</sup>

### ***Added costs***

2.56 The committee heard the concerns of some submitters that regulatory costs would increase, and be passed on to consumers. For example, the Corporate Superannuation Association submitted that the remuneration of independent directors would increase costs which would then be borne by members of the superannuation fund.<sup>63</sup>

2.57 AIST also expressed concerns at potential costs to superannuation fund members of implementation costs and higher director fees:

AIST is concerned at the level of board disruption that is proposed within a short timeframe and cautions against such significant changes being implemented in haste. The impact on decision-making and boardroom culture poses a risk to the best interest of members. Coupled with the proposed removal of the two-thirds voting rule, AIST believes that good governance practices will be diminished as a result, with members bearing the cost.

AIST submits that the proposed changes will impose significant costs (both through implementation and ongoing higher director fees) and introduce risks to the industry for no good reason.<sup>64</sup>

2.58 Ms Eva Scheerlinck, Executive Manager, Governance and Stewardship, AIST, told the committee that:

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60 Australian Institute of Superannuation Trustees, *Submission 7*, p. 20.

61 Australian Institute of Superannuation Trustees, *Submission 7*, p. 20.

62 Industry Super Australia, *Submission 12*, p. 28.

63 Corporate Superannuation Association, *Submission 5*, p. 2.

64 AIST, *Submission 7*, p. 4.

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[t]here are a number of different costs associated, in the first instance, with the recruitment of new directors. This being a different pool of directors that would need to be sourced, there would be different models. Whether or not that involves advertising using external requirement agencies, for example, there are obviously costs associated with that. Our research indicates that that would be approximately \$40,000 per independent director and up to \$100,000 for a chair, despite the fact that in our industry many of the directors are paid, on average, \$60,000 per annum. So the search cost is with it using external recruiters at that level.<sup>65</sup>

2.59 BOC Super also submitted that the requirement for one third independent directors would increase costs, estimating that their operations cost base would increase by 10 per cent to 25 per cent.<sup>66</sup>

### **Mergers and acquisitions**

2.60 The committee heard that a potential effect of the bill would be to encourage merger activity in the superannuation fund industry. The FSC submitted that:

An important outcome of the introduction of independent directors will be the role...these new directors will play in supporting industry consolidation to the benefit of consumers. Merger activity, in conjunction with the opening of the superannuation industry to competition, will reduce costs in the industry and put downward pressure on fees for consumers.<sup>67</sup>

2.61 The FSC expressed the view that independent directors would be able to critically examine the viability of inefficient and underperforming funds, with a view to a potential merger with a more efficient fund. The FSC drew upon analysis from Rice Warner and statements from senior superannuation executives, and put to the committee that 'it is clear that independent directors on superannuation boards would be expected to increase merger activity'.<sup>68</sup>

2.62 ASFA, however, disputed that the proposed changes in the bill would promote fund mergers:

It's a very long bow to suggest the proposed governance changes will drive merger activity. Indeed an independent director whose livelihood may solely depend on the number of board positions they hold may face an even more difficult decision than a representative trustee director who has an alternate main form of employment.

There is no empirical evidence to suggest that mandating independent directors would give rise to increased mergers.<sup>69</sup>

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65 Ms Eva Scheerlinck, Executive Manager, Governance and Stewardship, AIST, *Committee Hansard*, 28 October 2015, p. 8.

66 BOC Super, *Submission 9*, p. 4.

67 FSC, *Submission 1*, p. 1.

68 FSC, *Submission 1*, p. 3.

69 ASFA, *Submission 12*, p. 14.

### **Strict Liability Offence**

2.63 Proposed new section 92 will create an offence for failure to comply with a direction from APRA related to governance arrangements for an entity, and makes the offence one of strict liability. The committee notes that this proposed section was considered by the Senate Scrutiny of Bills Committee, which drew Senators' attention to the provision, stating that it may be considered to trespass unduly on personal rights and liberties. However the Senate Scrutiny of Bills Committee left it to the Senate as a whole to determine whether the proposed approach is appropriate on the basis that it was provided with detailed information to justify the approach.<sup>70</sup>

### **Committee view**

2.64 The committee is of the view that the bill contains provisions designed to ensure that superannuation funds have the flexibility to select independent directors who have the relevant skillset to aid fund performance, and which brings governance of regulated superannuation funds in line with international best practice standards of corporate governance. The committee notes that superannuation is a significant asset for Australian households, and that a very high standard of governance is required to ensure that Australians' superannuation is protected into the future.

2.65 This bill will allow superannuation fund boards to draw from a broader pool of independent directors, increasing diversity.

2.66 The committee notes the concerns of submitters and witnesses in relation to unintended consequences regarding representation of members' interests and added costs, but believes that the bill contains mechanisms to address these risks.

### **Recommendation 1**

**2.67 The committee recommends the bill be passed.**

**Senator Sean Edwards**

**Chair**

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70 Scrutiny of Bills Committee, *Alert Digest 11/15*, p. 36.