

Dissenting Report by Labor Senators

1.1 Labor Senators are concerned that this bill is seeking to impose a significant ideological shift from a model of *trustee* governance to model of *shareholder* governance, that there is no clear and compelling evidence that the changes are warranted, and that there is widespread concern the definition of 'independence' contained in the bill is ambiguous.

1.2 The most concerning aspect of this bill is that it blindly conflates and confuses trustee governance with shareholder governance, rather than contrasting the two. Under a trustee governance model, board directors have a fiduciary duty to their *trustee-members*: the customers who are buying into the fund. Under a shareholder governance model, board directors have a fiduciary duty only to their *shareholder* owners. This Bill will impose a model of shareholder governance on boards currently operating under a trustee governance model.

1.3 Hearings have revealed supporters of the bill demonstrating a troubling pattern of cherry picking favourable data, attempting to present unrelated data, and failing to present quantitative evidence to support many of their assertions.

1.4 An alarming majority of submissions expressed concerns at the ambiguous and prescriptive definition of 'independence' contained in the bill (including some submissions expressing in-principle support the bill).

Referral and conduct of the inquiry

1.5 Labor Senators note that this bill was dumped into the House of Representatives by outgoing Assistant Treasurer Josh Frydenberg two days after the leadership spill that ended Tony Abbott's Prime Ministership. The bill demonstrates an ideological commitment to replace a model of trustee governance with one of shareholder governance.

1.6 In Minister Frydenberg's second reading speech to the House, he makes several factual errors, including some contradicted in the Explanatory Memorandum. The most egregious claim is his assertion that the bill will bring Australian superannuation funds in line with international best practice:

This bill amends the Superannuation Industry (Supervision) Act 1993 to introduce a higher standard of governance for superannuation funds, in line with domestic and international best practice.¹

1.7 But sections 2.48-2.50 of the Explanatory Memorandum for this bill clarify that pension funds in New Zealand, Canada, the US and the UK operate quite differently, usually under an equal representation model:

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

(2.48) ...The New Zealand *Superannuation Schemes Act 1989* does not have this independent trustee requirement and, therefore, non-KiwiSaver superannuation schemes (including complying schemes) have no qualification requirements attached to the role of the trustee.

(2.50) In Canada, multi-employer plans established pursuant to a collective agreement are governed by a board of trustees composed in accordance with the plan or collective agreement (typically equal representation — that is, that the board of a corporate trustee must consist of equal numbers of employer representatives and member representatives; In the United States, multi-employer (Taft-Hartley) funds must have equal representation of employers and employees; In the United Kingdom, at least one-third of trustees must be member-nominated.²

1.8 Minister Frydenberg explicitly re-states his commitment to a model of shareholder governance:

The changes fulfil the government's election commitment to align governance in superannuation more closely with the corporate governance principles applicable to ASX listed companies.³

1.9 But the changes proposed in the bill go far beyond an alignment with the ASX principles, which offer a voluntary framework for boards to consider. This bill will impose highly prescriptive changes, coupled worryingly with an ambiguous definition of independence. This was confirmed in testimony provided during hearings by Vicki Wilkinson of Treasury, who clarified 'it is broader than the ASX definition'⁴:

1.10 Minister Frydenberg goes on to erroneously claim that the bill is consistent with the Cooper review recommendations:

The changes this bill makes are consistent with the Cooper review recommendations and observations.⁵

1.11 But the changes proposed in this bill are *not* consistent with the Cooper Review recommendations, which proposed (in frustratingly dense text), that non-equal representative trusts (i.e. retail and bank owned funds) should have a majority of 'non-associated' trustee-directors⁶; and that funds with an equal representative trustee structure:

2 Australian Government, *Explanatory Memorandum*, Superannuation Legislation Amendment (Governance) Bill 2015, p. 42.

3 Hon Josh Frydenberg MP, Assistant Treasurer, *House of Representatives Hansard*, 16 September 2015, p. 10,341.

4 *Committee Hansard*, 28 October 2015, p. 32.

5 Hon Josh Frydenberg MP, Assistant Treasurer, *House of Representatives Hansard*, 16 September 2015, p. 10,340.

6 Cooper Review Recommendation 2.6, p. 26, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf.

...that no less than one-third of the total number of member representative trustee-directors must be non-associated, and no less than one-third of employer representative trustee-directors must be non-associated.⁷

1.12 Despite the unfortunate circumstances surrounding the introduction of the bill and the erroneous claims made by Minister Frydenberg, Labor Senators acknowledge the cooperation of Government Senators on the Senate Economics Legislation Committee in agreeing to hold two public hearings in Sydney and Melbourne, and allowing the invitation of witnesses broadly critical of the bill and its objectives.

Conflating two different models of governance

1.13 As Labor Senators note above, both Minister Frydenberg's second reading speech and the Treasurer's Explanatory Memorandum conflate and confuse shareholder governance with trustee governance, rather than contrasting the two – but Labor Senators note with exasperation that this distinction is clearly made in both the Cooper review and also in the Treasury consultation paper, and that these have been referenced quite clearly in sections 1.14 and 1.21 respectively of this report.

1.14 The Productivity Commission has previously warned against imposing a new structure on super boards. Its 2012 inquiry 'Default Superannuation Funds in Modern Awards' examined fund governance and concluded that it was 'not persuaded that additional prescriptive criteria are warranted'⁸.

1.15 The Association of Superannuation Funds of Australia (ASFA) submitted that by imposing a single model on all superannuation funds, that the bill may have unintended consequences:

It should also be recognised that there are many different structures and sizes across the sector and a 'one size fits all' approach may have unintended consequences particularly for small non-public offer funds. As such, it is important that the final legislation and the APRA prudential standards are sufficiently principles-based and place the accountability for the best outcomes for fund members on the Trustee Boards⁹.

1.16 In testimony before the committee, Mr Tom Garcia of the Australian Institute of Superannuation Trustees (AIST), and who is a member of the ASX governance council, was blunt in his opposition to the bill:

We oppose both its reach and its drafting. We absolutely oppose the abolition of equal representation and see it as a retrograde step for our

7 Cooper Review Recommendation 2.7, p. 27, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf

8 Productivity Commission, *Default Superannuation Funds in Modern Awards*, No. 60, 5 October 2012, p. 91, <http://www.pc.gov.au/inquiries/completed/default-super/report/default-super.pdf>.

9 ASFA, *Submission 14*, p. 2.

superannuation system. Further, we dispute the stated objectives and question if in fact this bill will achieve them.¹⁰

1.17 In their submission response to the exposure draft of the bill, AIST draws a clear distinction between the two models of governance:

In a listed company context, independent directors are there to protect minority shareholders and to ensure independence from management. In the not-for-profit superannuation sector these protections are neither relevant nor necessary - minority shareholders don't exist and superannuation funds are required by law to act in the best interests of all beneficiaries. A trustee is not a listed company in function or in form, and these changes fail to recognise that fundamental difference.¹¹

1.18 This government's insistence on conflating the two forms of governance is alarming.

Definition of Independence

1.19 A majority of submissions expressed concerns at the ambiguous and prescriptive definition of 'independence' contained in the bill (including some submissions expressing 'in-principle support' the bill).

1.20 The Chair has kindly included some of these concerns in sections 2.17 to 2.20 of this report:

- (2.17) The Governance Institute of Australia (“set out the principle of independence, but not prescribe a definition”)
- (2.18) Mercer Consulting (would prefer a “principles based” definition)
- (2.19) Australian Institute of Company Directors (“could be broader”)
- (2.20) Australian Industry Group (“overly restrictive”).

1.21 In their submission to the inquiry, the Association of Superannuation Funds of Australia (ASFA) offer a considered critique of the definition of 'independence', which is a critical component of this bill:

ASFA recommends that the definition of 'independent' in the legislation be amended to enable organisations to retain the ability to have common independent directors on the boards of RSEs under the same financial conglomerate group, rather than having to rely on APRA to make a determination on a case-by-case basis.

We believe that, on balance, this is an appropriate exclusion given that there are no limitations proposed in the revised draft legislation on an individual holding office as director on multiple unrelated RSE licensees.

10 Mr Tom Garcia, *Committee Hansard*, 28 October 2015, p. 8

11 AIST, *Reforms to Superannuation Governance*, p. 7, https://www.aist.asn.au/media/646736/20150723_submission_treasury_boardgovernance_final.pdf.

In our view, allowing directors to sit on multiple unrelated RSE licensees where the RSEs are in competition with each other but not sit on multiple related RSE licensees within the same financial conglomerate group as an independent director would be a poor policy outcome.¹²

1.22 ASFA continues to criticise the governments definition of independence, noting that it could exclude otherwise entirely well qualified directors from consideration:

ASFA recommends that the definition of 'independent' in the legislation be amended so that recent executive officers and directors of firms that are suppliers to the RSE licensee, but who themselves have had no previous dealings with the RSE licensee, should be allowed to be appointed as an independent director.

For example, a former tax partner (within the last three years) of a firm that currently provides audit services to the fund, but who has never themselves had any dealings with the fund, should not be precluded from being appointed as an independent director.

ASFA recommends that the legislation be amended to clarify that the mere fact of being a director on the trustee board does not result in the individual being deemed to have a material business relationship that precludes them from being considered 'independent'(Ibid).

Poor data

1.23 This inquiry has revealed supporters of the bill demonstrating a troubling pattern of cherry picking favourable data, attempting to present unrelated data, and failing to present quantitative evidence to support many of their assertions.

1.24 The Association of Superannuation Funds of Australia (ASFA) acknowledge that evidence tendered to the inquiry about the correlation between director independence and strong governance is ambiguous at best:

Some have argued that having independent directors has the potential to add significant value to the decision making process and improve the overall performance of the trustee board. However, others have argued that forcing boards to have a certain number or proportion of independent directors could, if anything, result in less discursive boards and, ultimately, potentially inferior decision-making.¹

1.25 The Australian Institute of Superannuation Trustees (AIST) submission provides a list of claims made in support of this bill that are not backed by evidence (and again also emphasizing the distinction between trustee governance and shareholder governance):

To date no evidence has been presented that:

- The current representative trustee model of governance is broken;
- The proposed model will improve member outcomes;

12 ASFA, *Submission 14*, p. 6.

- The proposed model will not result in less favourable member outcomes;
- Explains why a mandated number of independents must be applied to equal representation models of governance when the concept of independents – and therefore the need for them - arose where structural conflicts exist in companies acting as trustees of for-profit 'retail' superannuation funds. These structural conflicts – which exist between the duties of executives as directors and their duties to the shareholders to maximise profit - simply do not exist in not-for-profit superannuation funds.

1.26 The Financial Systems Inquiry also concedes that there is little evidence to support imposing these changes by legislation:

Although there is little empirical evidence about the relationship between quality of governance in Australian superannuation funds and their performance, high-quality governance is essential to organisational performance.¹³

1.27 The most concerning example of this lack of diligence was the unprecedented political intervention of APRA member Helen Rowell, who delivered a speech ironically titled *Facts, Fallacies, and the Future*, at the AIST Governance Ideas Exchange Forum in Melbourne on Tuesday 20 October, 2015, but under direct questioning at this inquiry, was forced to concede that 'it is very difficult to put any quantitative measure' on the benefits that she was asserting.

Recommendation 1

Labor Senators recommend that the bill not proceed.

Senator Chris Ketter

Deputy Chair

13 Financial System Inquiry, *Governance of superannuation funds*,
<http://fsi.gov.au/publications/final-report/chapter-2/super-governance/>