

The Senate

Economics
Legislation Committee

Superannuation Legislation Amendment
(Trustee Governance) Bill 2015 [Provisions]

November 2015

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Chapter 1

Introduction and background to the bill

Referral and conduct of the inquiry

1.1 On 17 September 2015 the Senate Standing Committee for Selection of Bills referred the provisions of the Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (the bill) to the Senate Economics Legislation Committee for inquiry and report by 9 November 2015.¹

1.2 The bill was introduced into the House of Representatives on 16 September 2015 by the then Assistant Treasurer, the Hon Josh Frydenberg MP.

1.3 The committee advertised the inquiry on its website and received 25 submissions. The committee held two public hearings: in Sydney on 23 October 2015 and in Melbourne on 28 October 2015. A list of the submissions received is at Appendix 1. A list of witnesses who appeared at the public hearing is at Appendix 2. The committee thanks all who contributed to the inquiry.

Purpose of the bill

1.4 The bill, if passed, will affect two major changes: it will require all superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) to have at least one third independent directors, and appoint an independent chair. APRA does not regulate self-managed superannuation funds. This role is performed by the Australian Taxation Office.

1.5 The changes proposed in the bill will apply equally to all regulated superannuation funds, including corporate, industry, public sector, and retail funds. A three year transition period is planned for established fund trustees to assist them to transition to the new requirements.²

1.6 At the time of introduction, the then Assistant Treasurer the Hon Josh Frydenberg MP said that the bill will 'amend the Superannuation Industry (Supervision) Act 1993 to introduce a higher standard of governance for superannuation funds, in line with domestic and international best practice',³ and that 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'.⁴

1 *Journals of the Senate* No. 118, 17 September 2015, p. 3146.

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

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

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

Structure of the report

1.7 This report comprises two chapters. The remaining part of this chapter sets out the background to the bill and provides an overview of the bill and the proposed changes. The second and final chapter considers the issues raised in submissions, and in hearings. The committee's overall conclusion can be found at the end of the next chapter.

Background

1.8 In its 2013 election commitment, the Coalition announced that it would introduce changes to corporate governance standards as they apply to superannuation funds, proposing to make 'appropriate provision for independent directors on superannuation fund boards'.⁵

1.9 This election commitment policy stated that the Coalition would align corporate governance in superannuation more closely with the corporate governance principles applicable to companies listed on the Australian Stock Exchange (ASX),⁶ stating that the Cooper Review into the governance, efficiency, structure and operation of Australia's superannuation system had 'questioned the financial expertise and professionalism of union and employer trustees who are appointed to superannuation boards through the 'equal representation model'.⁷

1.10 The *Superannuation Industry (Supervision) Act 1993* (SIS Act) establishes the governance rules and supervision arrangements that apply to the different types of prescribed superannuation funds. Under Part 9 of the SIS Act, boards of registrable superannuation entities (RSEs, or RSE licensees) (or groups of individual trustees) acting as trustees of standard employer-sponsored superannuation funds of five or more members must consist of equal numbers of employer representatives and member representatives. There can also be an additional independent director if such an appointment is permitted under a fund's governing rules and is requested by the employer or member representatives on the board.⁸

1.11 The current superannuation governance framework contains the requirement for some superannuation trustee boards to have equal representation. This is usually employer-sponsored funds, and is based on the principle that members should have a greater voice through representation on non public offer funds.

1.12 The Explanatory Guide to the bill, published by the Commonwealth government, notes:

Not for profit funds and corporate funds typically operate under equal representation arrangements. By contrast, retail funds (including Financial Services Council (FSC) member entities) have no restrictions in appointing

5 Liberal Party of Australia, *The Coalition's Policy for Superannuation*, 2013, p. 4.

6 Liberal Party of Australia, *The Coalition's Policy for Superannuation*, 2013, p. 5.

7 Liberal Party of Australia, *The Coalition's Policy for Superannuation*, 2013, p. 5.

8 Australian Government, *Explanatory Guide*, Superannuation Legislation Amendment (Governance) Bill 2015, p. 1.

independent directors and from 1 July 2014 are required, under FSC's selfgoverning standard, to have a majority of independent directors and an independent chair.

Therefore an objective of setting a minimum standard in terms of the number of independent directors on all superannuation trustee boards is to promote good governance by broadening each board's pool of experience and expertise. In addition, independent directors allow for an increased accountability of decisions made by other directors who may have conflicting interests.⁹

Cooper Review

1.13 The Super System Review was a review of the superannuation system that commenced on 29 May 2009 and was commissioned by the Commonwealth government. The review was chaired by Mr Jeremy Cooper and is therefore often referred to as the Cooper Review. The Cooper Review's final report was handed to the government on 30 June 2010.¹⁰

1.14 The Cooper Review observed that trustee governance structures had not kept up with developments in the industry and considered that the ASX corporate governance principles that apply to ASX listed companies formed a good starting point for governance arrangements that should apply to superannuation fund trustees.¹¹

1.15 The Cooper Review recommended that trustee boards be required to have a certain proportion of what was termed 'non-associated' trustee-directors. Non-associated directors would not be connected to, or associated with, employer sponsors, entities related to the trustees, employer groups, unions, service providers or current or former executives of the fund or a related entity.¹²

1.16 For boards that were not established on the equal representation model, the Cooper Review recommended that the trustee must have a majority of non-associated directors. For boards that apply the equal representation model, the review recommended that one-third of the trustee-directors be non-associated.¹³

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

10 Australian Government, *Stronger Super — Government response to the Super System Review*, December 2010, p. 1, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf (accessed 3 November 2015).

11 Swoboda, Kai, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015', *Bills Digest*, p. 7.

12 Australian Government, *Stronger Super — Government response to the Super System Review*, December 2010, p. 55, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf (accessed 3 November 2015).

13 Swoboda, Kai, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015', *Bills Digest*, p. 7.

ASX Corporate Governance Principles

1.17 The ASX convenes a Corporate Governance Council that brings together various business, shareholder and industry groups. Since 2003 the Council has developed and released recommendations on the corporate governance practices to be adopted by ASX listed entities.

1.18 Under Listing Rule 4.10.3, ASX listed entities are required to:

...benchmark their corporate governance practices against the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why. The rule effectively encourages listed entities to adopt the Council's recommended practices but does not force them to do so. It gives a listed entity the flexibility to adopt alternative corporate governance practices, if its board considers those to be more suitable to its particular circumstances, subject to the requirement for the board to explain its reasons for adopting those alternative practices.¹⁴

1.19 The current version of the Council's Corporate Governance Principles and Recommendations (Third Edition) was released on 27 March 2014 and takes effect for a listed entity's first full financial year commencing on or after 1 July 2014.

Consultation and Exposure Draft

1.20 On 28 November 2013, the Commonwealth government released a consultation paper titled 'Better regulation and governance, enhanced transparency and improved competition in superannuation'. The purpose of the paper was to seek feedback on 'governance and transparency issues contained in the Government's superannuation election commitments'.¹⁵

1.21 One of the key issues for consultation was articulated by the Department of the Treasury as being:

How best to ensure an appropriate provision for independent directors on superannuation trustee boards. Issues canvassed include how 'independence' could be defined and what could constitute optimal board composition.¹⁶

1.22 On 26 June 2015 the Commonwealth released an exposure draft of legislation.

1.23 The exposure draft proposed that:

14 ASX, *Corporate Governance Council*, <http://www.asx.com.au/regulation/corporate-governance-council.htm> (accessed 3 November 2015).

15 Department of the Treasury, *Better regulation and governance, enhanced transparency and improved competition in superannuation*, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2013/Better-regulation-and-governance> (accessed 28 September 2015).

16 Department of the Treasury, *Better regulation and governance, enhanced transparency and improved competition in superannuation*, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2013/Better-regulation-and-governance> (accessed 28 September 2015).

- all Australian Prudential Regulation Authority (APRA) regulated superannuation funds, including corporate, industry, public sector, and retail funds, have a minimum of one third independent directors on their trustee board and an independent chair; and
- consistent with rules that apply to ASX listed companies, trustees of APRA-regulated super funds would be required to report on whether they have a majority of independent directors, on an 'if not, why not' basis, in their annual report.

1.24 At the time of releasing the exposure draft, the government noted the proposal that a minimum one third of directors be independent and that an independent chair be appointed, was 'in-line with several recent independent reviews of the superannuation system that recommended that superannuation trustee boards include a higher number of independent directors'.¹⁷ These reviews included the 2010 Cooper Review, which recommended that boards have a minimum of one third independent directors, and the Financial System Inquiry (FSI) which recommended that boards have a majority of independent directors, including an independent chair.¹⁸

1.25 When the exposure draft was released, the government noted that it had considered the FSI recommendation that a majority of independent directors be required but decided that 'the proposal for one third independent directors and an independent chair, will substantially strengthen governance arrangements for the benefit of fund members'.¹⁹

1.26 The definition of independent, defined in proposed section 87 of the exposure draft to the bill, was stated as:

...persons who do not have a substantial holding in the trustee or do not have (or have not had within the last three years) a material relationship with the trustee, including through their employer...²⁰

1.27 Submissions on the exposure draft were invited, and closed on 23 July 2015. Thirty-one submissions were received, including three confidential submissions. Published submissions are available on the Treasury website.²¹

1.28 Amendments to the bill were made as a result of the consultation process. These included amendments to the definition of independent; clarifying APRA's role

17 Hon Josh Frydenberg MP, Assistant Treasurer, *Media Release*, 26 June 2015.

18 Hon Josh Frydenberg MP, Assistant Treasurer, *Media Release*, 26 June 2015.

19 Hon Josh Frydenberg MP, Assistant Treasurer, *Media Release*, 26 June 2015.

20 Clause 87, *Exposure draft, Superannuation Legislation Amendment 3 (Governance) Bill 2015*; Department of the Treasury, *Summary of Consultation Process*, http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Reforms%20to%20Superannuation%20Governance/Key%20Documents/PDF/Consultation_Summary_-_Final.ashx (accessed 29 September 2015).

21 Published submissions are available at the following link: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Reforms-to-Superannuation-Governance/Submissions>.

in determining independence, and adopting technical drafting suggestions to ensure that there were no unintended consequences as a result of the legislation.²² A table setting out these amendments is contained in Attachment B to the Treasury submission.²³

Provisions of the Bill

1.29 The bill has two schedules, and six parts in total. Schedule 1 of the bill sets out proposed governance arrangements for registrable superannuation entities (RSEs or RSE licensees), and Schedule 2 sets out proposed governance arrangements for the Board of the Commonwealth Superannuation Corporation (CSC).

1.30 Schedule 1, Parts 1-3, makes proposed amendments to the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to require that one third of the board of RSEs, or RSE licensees are independent from the RSE licensee, and that the chair of the RSE licensee's board of directors is independent from the RSE licensee.

1.31 Proposed new section 87 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. The Explanatory Memorandum to the bill sets out that conditions relating to ownership and relationships could determine that a person is not independent:

New section 87 provides two sets of conditions that, if present, would result in a person not being considered to be independent.

- The first set (87(1)(a) to (c)) relates to ownership (or structural) arrangements relating to the RSE licensee.
- The second set (87(1)(d) to (f)) relates to relationships an RSE licensee might have.²⁴

1.32 Proposed new section 88 allows APRA to determine if a person is independent, having regard to certain conditions set out in the bill. APRA may be asked to make a determination in writing by an RSE licensee.

1.33 Proposed new section 89 sets out how an application may be made that a person is independent from an RSE licensee, and proposed new section 90 provides that APRA may determine that a person is not independent from an RSE licensee.

1.34 Part 2 of Schedule 1 provides for proposed consequential amendments to the SIS Act.

22 Department of the Treasury, *Summary of Consultation Process*, http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Reforms%20to%20Superannuation%20Governance/Key%20Documents/PDF/Consultation_Summary_-_Final.ashx (accessed 29 September 2015).

23 Department of the Treasury, *Submission 21*.

24 Explanatory Memorandum, p. 14.

1.35 Part 3 of Schedule 1 sets out the proposed transitional arrangements, providing three years for established funds to implement the amendments to governance structures.

1.36 Schedule 2 of the bill sets out proposed governance arrangements for the Board of CSC, and seeks to amend the *Governance of Australian Government Superannuation Schemes Act 2011* to require the Board of CSC, which is the government's main civilian and military superannuation scheme, to comply with the requirements that would be introduced by the bill.

1.37 Under the *Governance of Australian Government Superannuation Schemes Act 2011*, the CSC is comprised of up to 11 directors (a chair plus 10 directors) with three nominated by the Australian Council of Trade Unions and two nominated by the Chief of the Defence Force.²⁵ The chair of the CSC is appointed by the Minister, with agreement of the Board.²⁶

1.38 Items 7 to 10 of Schedule 2 would '...facilitate a reduction in the number of directors (other than the chair) from 10 to 8, with the ACTU to nominate 2 directors rather than 3 and the Chief of Defence retaining the nomination of 2 directors'.²⁷ Items 11 and 15 of Schedule 2 translate this reduction in the overall number of directors from 10 to 8 (excluding the Chair) to a reduced quorum requirement from nine to six.²⁸

25 *Governance of Australian Government Superannuation Schemes Act 2011*, Section 11.

26 *Governance of Australian Government Superannuation Schemes Act 2011*, Section 12.

27 Swoboda, Kai, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015', *Bills Digest*, p. 22.

28 Swoboda, Kai, 'Superannuation Legislation Amendment (Trustee Governance) Bill 2015', *Bills Digest*, p. 23.

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.¹ 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 2025.² Superannuation accounts for around 27 per cent of Australian household net wealth.³

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.⁴

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:

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.⁵

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.⁶

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

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.⁸

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

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.

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.⁹

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.¹⁰

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.¹¹

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

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.¹²

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.¹³

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.¹⁴

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'.¹⁵

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.¹⁶

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;

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'.¹⁷

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'.¹⁸

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.¹⁹

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'.²⁰

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.

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.²¹

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'.²²

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.²³

APRA

2.26 APRA submitted that their present powers to address governance-related concerns are limited.²⁴ 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.²⁵

2.27 The bill, if passed, would provide APRA with the power to determine that a person is independent from an RSE licensee,²⁶ and also to determine that a person is not independent.²⁷ 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.²⁸

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

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.²⁹ CHOICE submitted that regulations that currently apply to deposit-taking, general insurance and life insurance industries provide a relevant precedent.³⁰ 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.³¹

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.³²

2.30 The AIST opposes APRA having the power to determine independence,³³ as does Industry Super Australia³⁴ and Mr Phillip Sweeney.³⁵

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.'³⁶

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.'³⁷

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.³⁸

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.³⁹

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'.⁴⁰

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.⁴¹ 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.⁴²

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

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.

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.⁴³

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.⁴⁴

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.⁴⁵

2.41 Representatives of the ACTU told the committee that the equal representation model was successful in fostering consensus in board decisions.⁴⁶ 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.⁴⁷

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.⁴⁸

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.⁴⁹

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'.⁵⁰ 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.⁵¹

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.⁵²

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

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*.

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.⁵³

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.⁵⁴

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.⁵⁵

2.50 ASFA supports the proposed three year transition period, and recommends that it begin on 1 July 2016.⁵⁶ The Australian Chamber of Commerce and Industry also supports the three year transition period.⁵⁷

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.⁵⁸

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.'⁵⁹

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

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.⁶⁰

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.⁶¹

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.⁶²

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.⁶³

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.⁶⁴

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

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.

[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.⁶⁵

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.⁶⁶

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.⁶⁷

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'.⁶⁸

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.⁶⁹

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.⁷⁰

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

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

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/>

Appendix 1

Submissions received

Submission Number	Submitter
1	Financial Services Council Attachment 1
2	Centre for Workforce Futures, Macquarie University
3	The McKell Institute
4	Mercer Consulting
5	Corporate Superannuation Association
6	UniSuper
7	Australian Institute of Superannuation Trustees
8	CHOICE
9	BOC Super
10	Australian Prudential Regulation Authority
11	ACTU 11.1 Supplementary to submission 11
12	Industry Super Australia
13	Australian Chamber of Commerce and Industry
14	Association of Superannuation Funds of Australia
15	Australian Industry Group
16	Council of Small Business Australia
17	Australian Institute of Company Directors
18	Mr Tony Tuohey
19	Governance Institute of Australia
20	National Seniors Australia
21	The Treasury
22	Australian Services Union
23	Mr Phillip Sweeney
24	Confidential
25	Confidential
26	Unions NSW
27	Suncorp

Additional information received by the committee

- Letter received from Industry Super Australia responding to an answer to a question on notice provided by the Financial Services Council on 3 November 2015.

Answers to questions on notice

- Answers to written questions on notice, received from the Treasury on 3 November 2015.
- Answer to question on notice from a public hearing held in Sydney on 23 October 2015, received from the Financial Services Council on 3 November 2015.

Appendix 2

Public hearings and witnesses

SYDNEY, 23 October 2015

BRAGG, Mr Andrew, Director of Policy, Financial Services Council

BRIGGS, Mr Blake, Superannuation Policy Manager, Financial Services Council

BROGDEN, Mr John, Managing Director and Chief Executive Officer, Australian Institute of Company Directors

BURRELL, Mr Steven, Chief Executive Officer, Governance Institute of Australia

CLARKE, Professor Thomas, Director, Centre for Corporate Governance, University of Technology Sydney

CROSBY, Mr Samuel, Executive Director, McKell Institute

DUNCAN, Ms Cathy, Executive Manager, Superannuation, Suncorp

EASSON, Dr Michael, Chair, Association of Superannuation Funds of Australia

FOX, Ms Judith, National Director, Policy & Publishing, Governance Institute of Australia

KIRKLAND, Mr Alan, Chief Executive Officer, CHOICE

LOANE, Ms Sally, Chief Executive Officer, Financial Services Council

McCREA, Mr Glen, Chief Policy Officer, Association of Superannuation Funds of Australia

MORGAN, Ms Gemma Kate, Senior Policy Adviser, Australian Institute of Company Directors

MORRISON, Ms Melina, Chief Executive Officer, Business Council of Co-operatives and Mutuals

RAFFERTY, Dr Michael, Researcher, McKell Institute

STRONG, Mr Peter, Chief Executive Officer, Council of Small Business Australia

TURNER, Ms Erin, Campaigns Manager, CHOICE

VAMOS, Ms Pauline, Chief Executive Officer, Association of Superannuation Funds of Australia

MELBOURNE, 28 October 2015

CERCHE, Mr Mark, Chairman, Corporate Superannuation Association

DALEY, Mr Brian, Capital Stewardship Officer, Australian Council of Trade Unions

FOGARTY, Mr Wayne David, Policy Analyst, Markets Group, Department of the Treasury

GARCIA, Mr Tom, Chief Executive Officer, Australian Institute of Superannuation Trustees

LINDEN, Mr Matthew, Director of Public Affairs, Industry Super Australia

MORRIS, Ms Carolyn, Senior Manager, Policy Development, Australian Prudential Regulation Authority

OLIVER, Mr David, Secretary, Australian Council of Trade Unions

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