

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.

