

2 February 2016

Mr Bernie Fraser
The Fraser Governance Review

via email: submissions@thefraserreview.com

Dear Mr Fraser

Good Governance and Superannuation Funds

The Australian Institute of Company Directors (AICD) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 37,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

Our views on the matter of governance of superannuation funds are well known. We believe that the members of superannuation funds will benefit from independence on their boards and that the sector has nothing to fear and much to gain from greater independence and transparency.

We make this submission to your review despite our view that the process is neither independent nor its terms of reference appropriately broad.

The AICD has previously provided views on the governance arrangements of superannuation funds in our submissions to Treasury and the Senate Economics Legislation Committee on the *Superannuation Legislation Amendment (Governance) Bill 2015*¹ (Exposure Draft). As noted in these submissions, it is our view that:

- Greater independence on the boards of superannuation funds should be encouraged consistent with internationally recognised principles of good governance. A majority representation of independent directors is desirable;
- To the extent possible, all APRA-regulated entities (including superannuation funds) should be held to the same standards of governance, with a consistent definition of "independent director" applied;
- Reforms requiring that at least one-third of the board must be independent and allowing a three year transition period should be progressed.

As a general comment, the AICD questions whether an optional code of conduct for one segment of the superannuation industry is the most effective framework for guiding governance practice. A consistent set of standards should apply to all funds based on recognised principles of governance, with a scope broader than independence of directors. Any such standards would best be set and monitored independently, for example through prudential standards and/or legislation as appropriate.

¹ AICD submissions to Treasury dated 23 July 2015 and the Senate Economics Legislation Committee dated 14 October 2015.

1. Adopting recognised principles of good governance

The Review has sought views on, in broad terms, "what the hallmarks of good governance for superannuation funds operating in Australia" should be and how performance against these standards should be assessed and monitored.

As a starting point, the AICD sees no convincing reason why not-for-profit funds should be treated differently from for-profit funds or other public entities that deal with public funds when it comes to adopting recognised standards of governance practice.

It is our view that the Review should look to the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (3rd ed) (ASX CGC Principles and Recommendations) which apply to all listed entities (including listed managed investment schemes) in Australia. We note that the Australian Institute of Superannuation Trustees and the Australian Council of Superannuation Investors are members of the ASX Corporate Governance Council (as is the AICD), which develops and updates the ASX CGC Principles and Recommendations. Adopting the ASX CGC Principles and Recommendations would require fund boards to consider their composition and competency beyond the limits of the current "representation model".

It has been noted that some not-for-profit superannuation fund boards are constrained by existing board composition requirements (by the *Superannuation Industry (Supervision) Act 1993*, their governing rules or both) from being able to appoint directors with the right mix of skills, experience and backgrounds to best serve the interests of members.² Applying the ASX CGC Principles and Recommendations, and in particular encouraging an increase in the number of independent directors on not-for-profit fund boards (discussed in greater detail below) will assist in addressing this concern and bring governance practices in line with those of other APRA-regulated entities and the standards of governance recognised as good practice for all corporates.

Using the ASX CGC Principles and Recommendations as a guide, governance arrangements for the boards of industry superannuation funds should:

- Have a diversity policy that includes a requirement that the board or a committee of the board sets measurable objectives for achieving gender diversity on the board (as well as at other levels in the organisation) and - annually assess and disclose achievement against those objectives (CGC Recommendation 1.5);
- Have a nomination committee or some other formal process to address board succession planning and to ensure that the board has an appropriate mix of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively (CGC Recommendation 2.1);
- Use a skills matrix to set out the skills, experience and backgrounds present on the board and to help identify any gaps that need to be addressed through professional development programs and/or board succession planning (CGC Recommendation 2.2);
- Have a majority of directors on the board classified as independent, consistent with the definitions applied through the ASX CGC Principles and Recommendations (CGC Recommendation 2.4);
- Have a Chair that is an independent director and not the same person as the CEO (CGC Recommendation 2.5);
- Have an induction program for directors and provide ongoing professional development opportunities for all directors to maintain the skills and knowledge necessary to perform their roles as directors (CGC Recommendation 2.6);

² See speech by APRA Member, Helen Rowell, delivered to the AIST Governance Ideas Exchange Forum, Melbourne, 20 October 2015.

- Have a code of conduct that clearly articulates acceptable practices for directors. This should include detailing the board's expectations with respect to conflicts of interest, noting that directors must not enter into any arrangement or participate in any activity that would conflict with the fund's best interests or that would be likely to negatively affect the fund's reputation. It should also set out the processes that are in place for handling actual or potential conflicts of interest (CGC Recommendation 3.1); and
- Undertake periodic performance reviews of the board, its committees and individual directors, including using external facilitators from time to time, and addressing any issues identified by such reviews (CGC Recommendation 1.6).

In terms of international examples of fund governance, we note that the guidance provided by the Financial Services Board of South Africa in its "Circular PF No. 130: Good Governance of Retirement Funds"³ as a useful reference. Circular PF No. 130 sets out the Financial Services Board's expectations for the retirement fund industry in South Africa with respect to their governance arrangements. It covers conflicts of interest, board composition and competency (amongst other governance matters), including a recommendation that the boards of multiple-employer funds and retirement annuity and preservation funds comprise at least 50% independent directors.⁴

2. The role and value of independent directors

As noted in our submissions on proposed legislative reforms on superannuation governance⁵, it is our view that greater independence on the boards of superannuation trustee companies is consistent with internationally recognised principles of governance.

It is widely accepted that independent directors play an important role in achieving good governance. There is an increasing expectation both in Australia and internationally for independent directors to be appointed to boards, with most stock exchange listing rules either requiring listed companies to have a majority of independent directors or to disclose on an "if not, why not" basis why they have less than a majority.

The Organisation for Economic Co-operation and Development (OECD) recognizes the important role of independent directors in its 2015 Principles of Corporate Governance:

*Independent board members can contribute significantly to the decision-making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition, they can play an important role in areas where the interests of management, the company and its shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions and the audit function.*⁶

The ASX Corporate Governance Council recommends that a majority of a board should be independent directors, and provides the following guidance in commentary:

To describe a director as "independent" carries with it a particular connotation that the director is not allied with the interests of management, a substantial security holder or other relevant stakeholder

³ A copy of Circular PF No. 130: Good Governance of Retirement Funds can be located on the Financial Services Board's website at

<https://www.fsb.co.za/Departments/retirementFund/Circulars/PF%20Circular%20130.pdf>

⁴ Note 3 above at paragraph 24.

⁵ Note 1 above.

⁶ OECD Principles of Corporate Governance, 2015, Principle VI.E(1), <http://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>

and can and will bring an independent judgement to bear on issues before the board. It is an appellation that gives great comfort to security holders and not one that should be applied lightly. A director of a listed entity should only be characterised and described as an independent director if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally.⁷

The Australian Council of Superannuation Investors, in its governance guidelines, notes that a board should be comprised of a majority of independent non-executive directors who are sufficiently motivated and equipped to fulfill the function of independent scrutiny of the company's activities:

Boards fulfil their supervisory and advisory functions by bringing an independent perspective to bear. Accordingly, independent non-executive directors perform a pivotal role in this regard. A person who is regarded as an independent, non-executive director is expected to be able to make decisions in the best interests of the company, and in a manner that is independent from management and free of any business (or other) relationship that could materially interfere with their judgement. This is particularly the case where there is potential for conflict of interest arising in a board decision, be it actual or perceived.⁸

APRA has demonstrated support for the inclusion of independent directors on the boards of organisations in other regulated industries under Prudential Standard CPS 510 which requires the boards of Authorised Deposit-taking Institutions (ADIs), general insurers and life companies to have a majority of independent directors at all times.⁹

Recently, in a speech delivered to the AIST Governance Ideas Exchange Forum in October 2015, APRA member Helen Rowell noted that:

The boards of all ADIs and general and life insurers have been required by APRA's prudential standards to have a majority of independent directors and an independent chairperson since 2006. And this applies – and, I might add, works well – even when the regulated entities are mutually-owned and not-for-profit.

The Financial Services Inquiry Final Report¹⁰ also recommended that there should be a majority of independent directors on the board of trustees of public offer superannuation funds, including an independent chair. It was noted that the existing governance arrangements for super funds are "inconsistent with good governance principles" and recommended that the government mandate a majority of independent directors be present on the boards all public offer funds (including not-for-profit funds).¹¹

⁷ Recommendation 2.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3rd ed*

⁸ ACSI Governance Guidelines: A guide for superannuation trustees to monitor listed Australian companies, October 2015, principle 8,

http://www.acsi.org.au/images/stories/ACSIDocuments/ACSI_Governance_Guidelines.Oct15.pdf

⁹ APRA, Prudential Standard CPS 510: Governance, July 2012, <http://www.apra.gov.au>

¹⁰ The Financial System Inquiry Final Report, November 2014.

¹¹ Recommendation 13 of note 10 above at p.133.

The AICD considers that independent directors can make a valuable contribution to the boards of not-for-profit superannuation funds, including:

- Independent directors can represent and protect the interests of significant groups that are unrepresented under the "equal representation" model. The Super System Review found that employer and employee representatives are often nominated by third party organisations, such as employer associations and trade unions, which do not necessarily represent the interests of all employers or employees.¹² As noted in the more recent Financial System Inquiry, the equal representation model has increasingly less relevance in the current superannuation system and, as more fund members exercise choice, directors appointed by employer and employee groups are less likely to represent the broader membership. Given this increased diversity of fund membership, the Final Report of the Financial System Inquiry concluded that "it is more important for directors to be independent, skilled and accountable than representative";¹³
- Independent directors can assist employer and employee representatives by providing a fresh, objective perspective to issues the board considers, particularly where employer and employee representatives may have similar backgrounds or strong stakeholder interests; and
- Independent directors can bring specialist skills and knowledge to the board, including investment, finance, director or trustee experience. Increasing the number of independent directors on fund boards can assist in ensuring there is an appropriate balance of skills, knowledge, experience and diversity on the board to enable it to discharge its duties and responsibilities effectively.

3. Defining "independence"

Consistent with the ASX CGC Principles and Recommendations, a director of a not-for-profit fund should only be considered independent "if he or she is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally."¹⁴

However, as noted in our previous submission to Treasury¹⁵, in attempting to define who should qualify as an "independent director", it is important to recognise that the determination of a director's independence involves an assessment of whether the director is, as a matter of practice, in a position to exercise independent judgment as a director. This assessment needs to take into account a number of factors that may impact on the director's ability to exercise independent judgment, including whether directors are appointed as representatives of particular stakeholder groups.

A board's determination as to whether or not a director is independent should ultimately be made based on whether the director is in fact independent of mind and in practice exercises their judgment in an unfettered and independent manner. A board would be expected to take into account all relevant interests, positions, associations and relationships that could impact on a director's ability to exercise independent judgment.

¹² Super System Review chaired by Jeremy Cooper, Final Report, (www.supersystemreview.gov.au) s.4.2.

¹³ Note 10 above at p. 135

¹⁴ Commentary to Recommendation 2.3 of note 7 above.

¹⁵ See AICD submissions to Treasury in relation to the Financial System Inquiry dated 23 July 2015 and 31 March 2015; and AICD submission to Treasury in response to its Discussion Paper, *Better regulation and governance, enhanced transparency and improved competition in superannuation* to Treasury dated 12 February 2014.

**AUSTRALIAN INSTITUTE
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Accordingly, the AICD is supportive of a broad description of “independence”, similar to the one that is used for the purposes of Principle 2 under the Principles and Recommendations, namely:

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.

To provide an additional level of rigour, boards should disclose any instance where the board has determined that a director is independent notwithstanding the existence of one or more of the relationships noted above.¹⁶

Please do not hesitate to contact the AICD’s General Manager, Advocacy, Louise Petschler on 02 8248 8446 or lpetschler@aicd.com.au if you would like to discuss.

Yours sincerely



JOHN BROGDEN
Managing Director & Chief Executive Officer

¹⁶ Recommendation 2.3 of note 7 above.