

4 October 2017

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

via email: economics.sen@aph.gov.au

Dear Mr Raine

Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

Thank you for the opportunity to provide a submission to the Senate Economics Committee Inquiry into the Treasury Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 (**Bill**) and associated explanatory material.

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 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD strongly supports the government's aim of improving governance in superannuation. Given the significance of the superannuation sector to the financial wellbeing of Australians, the robustness of its governance is of particular importance to the nation.

This submission sets out the AICD's views and recommendations for the Bill. We note and recognise that this Bill has been introduced as one component of a package of reforms which aim to improve accountability and member outcomes within the superannuation sector. The AICD welcomes the actions taken by the government in furtherance of this aim.

We have written to the Committee separately in relation to the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017.

1. THE NEED FOR REFORM

In the AICD's view, increasing the independence of boards of all Registerable Superannuation Entity (**RSE**) licensees (**RSE Licensees**) will be a positive governance reform.

It is widely accepted that independent directors play a key role in achieving good governance, whether within the for-profit or not-for-profit sector. There is an established 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.

This international consensus is reflected in the latest Organisation for Economic Co-operation and Development (**OECD**) Corporate Governance Factbook, which observed the following in its survey of international board composition requirements:¹

Despite differences in board structure, almost all jurisdictions have introduced a requirement or recommendation with regard to a minimum number or ratio of independent directors. Six jurisdictions have established binding requirements for 50% or more independent board members for at least some companies...

¹ OECD, 'OECD Corporate Governance Factbook', (2016) 95.

The need for governance reform within the superannuation sector has been a significant recommendation of two major government inquiries. The Super System Review instigated by the former Labor government in 2009 and chaired by Jeremy Cooper recommended that at least one-third of board members be independent on boards with equal representation, and a majority be independent on all other boards.² The Financial System Inquiry went even and recommended that public offer superannuation funds have a majority of independent trustee board directors, including an independent chair.³

In addition, the Australian Prudential Regulation Authority (**APRA**) has demonstrated support for the inclusion of independent directors through various standards, including Prudential Standard CPS 510, which requires the boards of other APRA-regulated entities to have a majority of independent directors at all times.⁴

The AICD acknowledges that the presence of independent directors, and an independent Chair, is an important, but not sufficient condition to promote good governance. The collective qualifications, education, experience and skill-set of a board play a critical role in supporting good governance.

Having said that, the benefits of independence on boards are recognised across many governance codes and guidelines in Australia. This includes the ASX Corporate Governance Council's guidelines which apply to all ASX-listed companies in Australia.⁵ The Australian Council of Superannuation Investors (ACSI) also recognises the benefits of independence as a contributor to good governance, noting that:⁶

A board's capacity to effectively scrutinise the activities of the company and its officers is directly affected by the input of a diverse range of independent and skilled directors. A board should be comprised of a majority of independent non-executive directors who are sufficiently motivated and equipped to fulfil the function of independent scrutiny of the company's activities.

In the AICD's view, superannuation funds should operate according to internationally recognised standards of good governance, including having independent directors on boards.

2. MAJORITY OF INDEPENDENT DIRECTORS IS RECOMMENDED

While we support the objectives of the Bill, the AICD recommends that the board composition requirement be amended to mandate a majority of directors to be independent. This would ensure enough independent directors on the board to meaningfully influence and affect the decisions of the board.

The one-third requirement, while improvement on the current regime, does not represent best practice, and is inconsistent with equivalent requirements applied to APRA-regulated entities,⁷ managed investment schemes,⁸ and ASX-listed companies (on an 'if not, why not' basis).

The introduction of a majority of independent directors on a superannuation board would, in the AICD's view, strengthen the governance of superannuation funds.

One of the benefits of independent directors on boards is their ability to challenge prevailing wisdom and bring a unique perspective to an organisation. It should not be assumed that independent directors vote as a single block. The introduction of only one-third of independent

² Super System Review, *Final Report – Part One: Overview and Recommendations*, Treasury, Australian Government, July 2010.

³ The Financial System Inquiry Final Report, November 2014.

⁴ APRA, Prudential Standard CPS 510: Governance.

⁵ Recommendation 2.1 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3rd ed.*

⁶ ACSI Governance Guidelines, October 2015, p 13

⁷ Australian Prudential Regulation Authority (APRA) 2012, Prudential Standard SPS 510: Governance, APRA, Sydney; APRA 2013, Prudential Standard SPS 521: Conflicts of Interest, APRA, Sydney.

⁸ *Corporations Act 2001*, s 601JA and s 601JB.

directors on superannuation trustee boards may not be sufficient to give full effect to the policy objectives of the Bill.

If this recommendation is not adopted, the requirement of an independent Chair becomes particularly critical.

3. THE DEFINITION OF INDEPENDENCE

The AICD recognises that mandated composition requirements is a feature of the governance of Australia's superannuation sector, and accepts that this will be the basis of sector governance regulation for the foreseeable future.

However, a director's independence is not, in our view, best judged by reference to fixed criteria in legislation. While we agree that there are certain relationships that are likely to be relevant to a board's consideration of a director's independence, independence should not be limited to finite list of factors.

In addition, the AICD has identified several potential deficiencies within the definition of independence:

- **s 87(1)(a)-(b):** The requirement to not hold 5% or more of the share capital of an RSE Licensee is unlikely to be meaningful in the context of superannuation funds, where shares are unlikely to be held by individual board members. In any event, this requirement would not apply to arrangements where the director's shareholding is held via a trustee.
- **s 87(1)(c):** The requirement to prevent a director from being 'independent' if a director or executive officer of a related body corporate during the preceding three years could prevent an otherwise independent director sitting on the board of a superannuation trustee board just because they also sit on the board of a related body's board.
- **s 87(1)(e):** This requirement may inadvertently capture a person who was a partner, executive officer, or employee of an entity which has a material business relationship with the superannuation trustee, in circumstances where that person was not directly involved in the business relationship with the RSE Licensee, such as a person who was a partner or employee of a professional services firm but had no director relationship with the trustee itself.
- **s 87(1)(f):** This requirement could still enable those with close associations with an employer-sponsor or an organisation representing the interests of employee members of the fund to be deemed an 'independent' director.

Given these matters, the AICD recommends that the Bill adopt a principle-based description of independence for directors of RSE Licensees under the *Superannuation Industry (Supervision) Act 1993 (SIS Act)*.

The AICD recommends that this be achieved by adopting a principles-based definition of independence, similar to Principle 2 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations (ASX Principles)*, namely:

An independent director is a director who is free of any interest, position, association or relationship that could influence, or could 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 prioritise the interests of beneficiaries.

This definition could be supplemented by a non-exhaustive list of factors to be considered in assessing the independence of a director, in a manner similar to Box 2.3 of the ASX Principles, either in the Bill or regulations, or via APRA through prudential standards.

The AICD favours a governance model which enables the RSE Licensee board to make the determination as to whether a person is independent, taking into account relevant factors. We

also support providing APRA with the power to determine that a person is not independent should APRA have concerns that a person is not in fact able to exercise independent judgment.

4. FURTHER IMPACTS ON BOARD COMPOSITION

The AICD recognises the limitations of the equal representation model, as highlighted by the Financial Systems Inquiry. However, we accept that there could be unintended consequences on broader RSE board composition, particularly if the requirement for independent directors is not amended to require a majority. We support further consideration of this issue.

5. CONCLUSION

We hope our comments will be of assistance to you. If you would like to discuss any aspect of this submission, please contact Matt McGirr, Policy Adviser, on (02) 8248 2705 or at mmcgirr@aicd.com.au.

Yours sincerely



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