

13 July 2018

Ms Karen Chester  
Deputy Chair  
Productivity Commission  
Locked Bag 2, Collins Street East  
MELBOURNE VIC 8003

*via email to super@pc.gov.au*

Dear Ms Chester

**Productivity Commission Stage 3 Draft Report on Superannuation: Assessing Efficiency and Competitiveness**

Thank you for the opportunity to provide a submission to the Productivity Commission's draft report, Superannuation: Assessing Efficiency and Competitiveness (**Draft Report**).

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 43,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD supports reform to strengthen governance practices in Australia's superannuation sector. A well-functioning superannuation system requires high-quality governance arrangements involving both robust fund governance, and diligent system governance. We welcome the work of the Productivity Commission as an important step towards achieving meaningful reform in the sector.

The Draft Report raises a number of significant structural issues relating to the sector. However, given our focus on excellence in governance and boardroom practice, the AICD has limited our submission to Draft Recommendation 5 and 6, along with the associated commentary and findings within Chapter 9 of the Draft Report.

**1. Overview**

The AICD recognises the draft findings of the Productivity Commission in relation to superannuation governance, which indicate the need for significant improvements in the sector. For this reason, the AICD supports measures which would strengthen the

requirements relating to governance practices in the superannuation sector, including those relating to board performance reviews, board appointment and board renewal processes.

Ordinarily, it would not be appropriate to prescribe specific governance practices on a mandatory basis, such as when to conduct a board performance review, or whether to use and disclose a skills matrix. It is almost always preferable to adopt an approach which is flexible and principles-based, similar to the ASX Corporate Governance Council Principles and Recommendations (**ASX Principles**), so that, amongst other things, boards can adapt governance practices to suit their unique circumstances and operating conditions.

However, given the unique nature of the superannuation sector, and given the significant concerns relating to superannuation governance which have been highlighted by the Draft Report and the Australian Prudential Regulation Authority (**APRA**) recent thematic review into the board governance of Registrable Superannuation Entity Licensees (**RSE Licensees**), we see merit in adopting a more prescriptive approach to some aspects of superannuation governance as suggested in Recommendation 5 of the Draft Report. For further discussion on this point see **section 2** of this submission.

In addition, the promotion of greater transparency in relation to merger decisions made by superannuation boards could encourage more consolidation in the sector, with the aim of reducing the number of underperforming funds in the sector and improving member outcomes. For this reason, the suggestion in Recommendation 6 presents a useful solution to the long tail of underperforming RSE Licensees. For further discussion see **section 3** of this submission.

Finally, the AICD reiterates its strong support for the removal of the restriction on the appointment of independent directors to superannuation boards. We consider that removing this restriction will enhance the ability of superannuation entities to appoint directors who have the necessary skills and experience to bring value to the board. For further discussion see **section 4** of this submission.

## **2. A stronger focus on board composition and governance practices**

The AICD strongly supports the Commission's suggestion that a stronger focus on board composition (particularly on trustees' mix of knowledge, skills and experience) would support better governance within the sector. For this reason, the AICD supports sensible measures which would encourage boards of RSE Licensees to:

- (a) Use and disclose a process to assess, at least annually, their board's performance relative to its objectives and the performance of individual directors;
- (b) Maintain a board skills matrix and annually publish a consolidated summary of it;  
and

- (c) Have and disclose a process to seek external third party evaluation of board, committee and individual director performance and capability at least every three years.

Each of the requirements listed above are sound governance practices that support effective and high-performing boards.

Should these proposed governance requirements be mandatory?

Ordinarily, it would not be appropriate to impose mandatory requirements in relation to governance practices such as those outlined above. For instance, mandating external third-party evaluations of board and committee performance goes further than the recommendations that apply to listed entities set out in the ASX Corporate Governance Council Principles and Recommendations (which merely suggest that boards of listed entities should consider periodically using external facilitators to conduct its performance reviews).

However, there are significant differences between listed entity boards and RSE Licensee boards (particularly in relation to director or trustee appointment processes and the role of sponsoring entities in the superannuation context), In addition, the superannuation sector has a number of special characteristics, namely its compulsory nature and absence of governance accountability measures found in corporate contexts (such as member voting rights and annual general meetings).

For these reason, and given the ongoing issues relating to superannuation governance identified in the Draft Report, we understand why you may choose to introduce more prescriptive governance requirements in an effort to support better governance practices within the sector.

Should these requirements be legislated?

The AICD supports the continuing role of APRA in appropriately crafting prudential standards for the superannuation sector which provide the sector with governance-related objectives and key requirements, without the need to introduce new legislation, or amend the *Superannuation Industry (Supervision) Act 1993 (Cth)* (**SIS Act**).

The use of APRA prudential standards is, in the view of the AICD, generally preferable to legislation in relation to imposing any governance-related standards in the sector. Our view is based on the following factors:

- The process undertaken when reviewing and amending APRA prudential standards enables greater participation and consultation from the superannuation sector itself, so that the requirements can be appropriately tailored to the needs of the sector;

- The standards are more readily amended by APRA should the need arise, which brings the benefit of greater flexibility for APRA to ensure that prudential regulation keeps pace with the evolution of superannuation sector than if the governance standards were placed in formal legislation;
- APRA's standards have the force of law pursuant to s 34C of the SIS Act, so there is no question of the standards being a more diluted version of the law; and
- There are benefits to consolidating governance related requirements where sensible to do so in that it may avoid fragmentation and confusion (as well as the perception that a certain set of requirements should be given more focus than another).

For this reason, while we support the policy objectives of Recommendation 5 in the Draft Report, we would prefer to see these measures implemented by way of amendments to Prudential Standard SPS 510 Governance (**SPS 510**), rather than by formal legislative amendment. We do not see any specific advantage in having these requirements legislated.

The recommendation relating to the legislative restrictions on the ability of superannuation funds to appoint independent directors is discussed in **section 4** below.

### **3. Greater transparency regarding mergers which do not proceed**

The AICD acknowledges the concern expressed by the Productivity Commission that there is a lack of transparency in relation to both members and APRA where mergers have not proceeded. The AICD also acknowledges the Commission's attempt to balance the need to encourage mergers within the sector, while not discouraging entities to engage in conversations about mergers at an early stage.

As discussed above, the AICD is generally cautious of any mandatory requirements relating to corporate governance requirements, particularly those which would require boards to disclose the deliberations associated with sensitive and difficult commercial decisions, and notes that unintended consequences may flow from such a requirement.

For example, the AICD is not wholly convinced the measure proposed in Recommendation 6 would necessarily encourage more mergers, given the reporting would only occur if the merger ultimately did not proceed. We are concerned that funds may hesitate to enter a memorandum of understanding, out of concern at having to explain a later withdrawal, even where all decisions have been taken with the interests of members as the primary driver.

However, we acknowledge that a disclosure requirements would promote greater transparency within the sector. Transparency and accountability are essential components of good governance, and are particularly important in the context of superannuation, given the

compulsory nature of Australia's superannuation sector, and the lack of standard accountability measures found in corporations, such as member voting rights, annual general meetings, and, in the case of listed entities, continuous disclosure obligations.

On balance, given the ongoing issues relating to underperforming funds, and the importance of encouraging greater transparency within the sector, AICD does not oppose the introduction of the reporting requirement suggested in Draft Recommendation 6, subject to the requirement being subject to an interim review, after at most two years, to ensure it is operating as intended. We encourage close engagement with the sector in the review process.

#### **4. Greater representation of independent directors on RSE Licensee boards**

##### Should the restriction on independent directors be removed?

The AICD has long advocated for the removal of restrictions on the ability of superannuation funds to appoint independent directors to trustee boards. While the AICD acknowledges that this issue is contested, we are of the view that removing this restriction will enhance the ability of superannuation entities to appoint directors who have the necessary skills and experience to bring value to the board.

For the benefit of the Productivity Commission, we attach our submission to the Senate Economics Legislation Committee dated 4 October 2017, in which we responded to the Bill and set out further arguments in favour of removing the restriction.

##### The definition of independence?

A director's independence is not, in our view, best judged by reference to fixed criteria in legislation alone. While we agree that there are certain formal relationships, such as those outlined in the *Superannuation Laws Amendment (Strengthening Trustee Arrangements Bill 2017 (Cth) (Bill)* that are likely to be relevant to a board's consideration of a director's independence, independence cannot be limited to these factors alone. In addition, the absence of those formal relationships does not, of itself, suggest that a candidate for nomination to an RSE Licensee board is independent in all the circumstances.

For this reason, we have previously recommended to the government that the Bill be amended so that the definition of independence reflected a principles-based approach. We continue to hold this view.

A principles-based definition could be achieved by adopting an amended version of Principle 2 of the ASX Principles, such as:

*An independent director is a director who is free of any interest, position, affiliation, or relationship that could influence, or could reasonably be perceived to influence, in a*

*material respect their capacity to bring an independent judgment to bear on issues before the board and to prioritise the interests of beneficiaries as a whole.*

This definition could (if further detail were considered appropriate) be set out in the Bill and 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. The factors could be set out in a revised version of SPS 510, the Bill or regulations.

In relation to whether APRA should be given a specific power to “approve” a director as independent, the AICD favours a governance model which enables the RSE Licensee board to make a determination as to whether a person is independent, taking into account relevant factors set out in a revised version of SPS 510. The AICD is of the view that APRA’s general powers to enforce compliance with SPS 510 would be sufficient to ensure compliance. It is also consistent with good corporate governance, and regulatory practice, to maintain an appropriate delineation between the functions of APRA as a supervisor, and the functions of the board of an RSE Trustee.

It must be emphasised that the removal of the restriction on appointing independent directors on RSE Licensee boards is a necessary, but not sufficient condition for good governance. As the Draft Report states, independent directors can improve governance, but skills, experience and fewer potential conflicts are just as important. In saying this, we would expect that removing the restriction would, amongst other things, enable and encourage RSE Trustee boards to look further afield when considering potential nominee directors.

## **5. Next steps**

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 8431 or [mmcgirr@aicd.com.au](mailto:mmcgirr@aicd.com.au).

Yours sincerely,



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