



# Reforms to Superannuation Governance Prudential Framework

26 October 2015

AIST Submission

## AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$600 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

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AIST appreciates the opportunity to comment on draft Prudential Standards SPS 510, SPS 512 and their corresponding Prudential Practice Guides SPG 510 and SPG 512.

At the time of writing, the *Superannuation Legislation Amendment (Trustee Governance) Bill 2015* to which the draft standards and practice guides relate has not yet passed through the parliament. We note that the draft regulatory package proposed by APRA is subject to the Bill passing in its current form, and that further consultations may be required if amendments are made.

On 31 August 2015, APRA released the discussion paper 'Governance Arrangements for RSE licensees' inviting comments on the draft prudential standards and practice guides released with the discussion paper. AIST has also had the opportunity to consider the Frequently Asked Questions released on APRA's website on 15 October 2015.

While AIST supports high standards of governance in the superannuation industry, we do not support the Government's reform package. AIST does not believe that the changes are warranted and is unconvinced about any resulting benefit to members.

AIST also believes that the draft prudential regulation package released by APRA should be less prescriptive and more principles-focused in its approach. The focus on independence in both draft SPS510 and SPG510 overstates the weight of independence as defined in the Bill. This may impede the efficient operation of superannuation funds, and increase, rather than reduce, risk.

AIST recommends that APRA ensures that its prudential governance framework features the right balance of the range of factors that help to ensure good governance and highly effective board decision-making.

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## 2 Introduction

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AIST opposes the Government's legislative package on superannuation governance and has continuously made representations to that effect at every opportunity since Jeremy Cooper recommended the introduction of mandatory independent directors on super fund boards in 2010. The facts have not changed, and no credible evidence has been presented that the Government's proposed reforms will lead to better retirement outcomes for the members of APRA-regulated superannuation funds.

AIST is a strong advocate of good governance practices and supports measures for continuous improvement. While we remain unconvinced that the proposed changes to the governance model of superannuation funds is necessary, and indeed of benefit to members, we make our submissions to APRA's proposed regulatory package in the spirit of facilitating meaningful and practical input into the implications for AIST's member funds and, ultimately, their members.

### 2.1 The aims of the reforms

The stated aims of the Government's reform package include broadening the pool of experience for each board and increasing accountability of decisions made by directors, particularly in relation to conflicts of interest.

AIST disputes that the proposed reform package will achieve these aims. The definition of independent directors arguably reduces the pool of talent for boards, and the requirement in proposed SPS510 that the independent directors have responsibility for chairing the board, the remuneration committee and the audit committee also potentially limits the pool of talent, and may increase rather than reduce risk.

AIST also submits that the existing conflicts of interest regime set out in the Superannuation Industry (Supervision) Act 1993 and SPS521 provide the regulator with sufficient powers to manage any conflict concerns that could jeopardise the best interests of super fund members. The imposition of a new, prescriptive class of mandated independent directors does not do away with conflicts. Indeed, the restrictive definition of independent arguably restricts the pool of eligible talent to a class of person more likely to suffer from conflicts of interest and conflicts of duty than representative directors who have no financial interests in the super fund. Not being tied into the corporate group that the RSE entity belongs to, representative directors do not have conflicts with regard to executive remuneration and incentives, and have no beneficial shareholder interests to protect.

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## 3 APRA's draft Prudential Standards and Practice Guides

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We now respond to the specific drafts of SPS510, SPS512 and their supporting practice guides circulated by APRA on 31 August 2015.

### 3.1 Governance framework requirements

AIST supports the development of governance frameworks to support the governance arrangements of superannuation funds. In the event that the governance package passes through both houses of Parliament, the new governance requirements will mean significant changes to the governance practices and structures of many of AIST's member funds. A lot of work will need to be done by super funds to embed the new requirements into their existing governance structures and working through the development of a framework, or amendment of an existing governance framework, will assist with that process.

However, while we agree that a written framework is useful, we caution that once in place, onerous requirements of review and monitoring should not attach. Stability in governance structures and practices should be a priority following yet another round of significant changes. Once in place, and implemented effectively, the governance framework should only require review when the fund undergoes significant change.

AIST notes the Government's response to the Financial System Inquiry includes proposing 'Statements of Expectations', particularly in relation to changes in regulatory architecture, for APRA to provide a greater focus on its performance assessment, to strengthen fund accountability and reduce red tape. The Government is seeking for these measures to come into effect by mid-2016. AIST submits that an SOE be produced for the proposed governance measures being considered in this consultation package, in order to contain the level of compliance costs associated with them.

#### 3.1.1 Board and committee size

Draft SPS510 requires the governance framework to include a policy on the size of the board and any board committees (SPS510.18(b)). The corresponding practice guide suggests that APRA would limit board size to 12 directors (SPG510.5).

AIST submits that the fund board is in the best position to determine what board size and composition mix is in the best interests of members and that regulatory limits on board size are inappropriate and interfere with the autonomous and efficient management of super fund entities. This, too, may increase rather than reduce the super fund's level of risk.

Of AIST's 62 member funds, six currently have boards of 12 or more directors. These arrangements may relate to the number of sponsoring organisations that support the fund, or may relate to a board composition that reflects the identified mix of skills and competencies that a board has identified it needs to fulfil its strategy. A board should be able to make decisions on the size of its board, taking into account

their particular circumstances and needs, and what they determine to be in the best interests of their members.

### 3.1.2 Policy for nominating, appointing and removing directors

AIST supports the proposed requirement for the development of policies relating to the nomination, appointment and removal of directors (SPS510.18(d)). However, the policy will need to be able to reflect the fact that in many instances, the power to nominate, appoint and remove directors does not rest with the board of the RSE licensee itself.

In the not-for-profit superannuation sector the rights of nomination, appointment and/or removal often lie with the sponsoring organisations of the fund. These rights are afforded to these organisations in recognition of their role as guarantors of the fund, and their rights to exercise this control (aside from the requirement to also appoint independent directors) has not been removed in the Bill currently before the Parliament. Implementation of the draft standard therefore needs to recognise this unique construct of many not-for-profit funds.

**AIST submits** that SPS510 be amended with regard to board policies of nomination, appointment and removal to reflect the fact that it is not at the board's discretion in many not-for-profit super funds. The drafting should therefore be broader to accommodate this circumstance.

### 3.1.3 Board composition and renewal

AIST is concerned that the draft standard and practice guide on governance is too focused on considerations of independence, at the expense of other more important factors for effective board composition. The draft 'key requirements' of SPS510 are listed as:

1. the board needing to appoint independent directors;
2. the board having a governance framework; and
3. board nomination, appointment and removal policies.

While we concede that the proposed changes to SPS510 were drafted in response to the Bill as it currently stands, we disagree that the appointment of independent directors is in fact a key requirement of good governance. It is merely a focus of the current Government and regulator, which has some limited influence on good governance outcomes.

Similarly, the focus on assessing independence when assessing director candidate suitability (SPS510.25(d)) also overstates the importance of independence criteria (as defined in the Bill) as opposed to other suitability criteria that the person can bring to the board such as:

- Appropriate skills that complement the skills of the existing board
- Personal attributes that will enhance the dynamic of the board
- Relevant experience

- Values alignment
- Appropriate cultural fit
- A preparedness to be held accountable for board decisions
- Relevant diversity elements

Similarly, draft SPG510 suggests that boards consider appointing more than the minimum one-third independent director requirement in considering their board renewal policy (SPG510.21) while also suggesting that boards disclose reasons for not having a majority of independent directors (SPG510.22). Again, we assert that the structural focus of independence, based on a definition AIST believes to be flawed, places too much emphasis on the wrong considerations. Instead, AIST submits that the regulator should require good governance practice based on sound principles that include a focus on appropriate management of conflicts, a relevant skills mix and compliance with fit and proper requirements.

**AIST submits** that independence is just one of many important considerations for boards for highly effective decision-making and that SPS510 and SPG510 should reflect a more principles-based approach, and the heavy weighting on independence should be adjusted.

### 3.1.4 Committee composition

AIST does not support further regulation of committee composition, in particular prescriptive requirements about the Chair and mix of classes of directors on the remuneration and audit committees of the board (SPS 510.42 – 43 and 52-54).

The board should be able to determine the best mix of skills and experience to serve on committees, and the Chair should be the best person for the job. Board and committee appointments are not made in a vacuum, and the existing Fit and Proper requirements - as well as the Conflicts of Interest obligations - continue to apply, and set appropriate frameworks for the operation of the fund's governing structures.

The focus on audit and remuneration chairing responsibilities will focus recruitment of independent directors on those skills areas and potentially impact the ability of funds to recruit relevant skills to facilitate their strategy, which may require different competencies. While we can see the argument for an independent Chair of the audit committee, we do not believe that the remuneration committee, in a not-for-profit fund, needs to be independent. In bank-owned retail funds, where some directors may be from within the corporate group, an independent Chair of the remuneration committee is, however, appropriate. The same conflicts, however, do not exist in the not-for-profit super fund sector.

The proposed changes to SPS510 in this regard are unwarranted and interfere with the autonomy of super fund boards to make decisions in the best interests of their members within the existing regulatory framework. This may impede the efficient operation of superannuation funds, and may increase rather than reduce risk.

**AIST submits** that mandated requirements of SPS 510.42 – 43 and 52-54 be removed from the SPS510 and instead moved to the prudential practice guide. AIST also submits that the Chair of the remuneration committee need not be an independent director where there are no executive directors on the board, but rather that it should be the best person for the job.

### 3.1.5 Continuous assessment of independence

SPS510.23 requires an at least annual review of the independence of individual directors, while SPG510.13 suggests the standard requires that ‘circumstances affecting the independence of independent directors are regularly reviewed and assessed’. Clearly the two statements are somewhat contradictory.

The definition in the Bill before the Parliament has a number of flaws as we have previously outlined in our submission to the Senate Economics Legislation Committee. AIST is of the view that it will have many unintended consequences and does not offer trustee boards the requisite certainty to be confident in whether individual directors meet the definition, and potentially continue to meet it while serving out their term.

The requirement to continuously review and assess the independence of directors classified as independent directors does not bring the required stability to board appointments that result in good governance and, ultimately, good member outcomes. While it is true that both the circumstances of the fund, and the circumstances of individual directors can change over time, these events could be managed in the conflicts management framework.

**AIST submits** that independent director appointments, once validly made within the requisite definition, should stand for the whole term unless a significant event occurs that clearly breaches independence. Otherwise, any issues should be managed as part of the conflicts management framework to allow boards to function effectively, without week-to-week stresses about ongoing compliance with the independent director definition.

### 3.1.6 Transition

As raised in previous submissions, AIST does not believe that a three-year transition period is appropriate for all funds while continuing to focus on delivering best outcomes to members and retaining a high functioning board throughout the transition period.

SPG512.5 states that:

“APRA expects each RSE licensee board to comply with the new governance requirements at the earliest reasonable opportunity, as seeking early compliance is likely to be in the best interests of members.”

AIST disputes that the changes are in the best interests of members and opposes the statement as it appears in the practice guide. APRA may consider early compliance with the law, provided the fund can maintain an appropriate level of expertise to make effective decisions, as preferable. However, should

funds require the full transition period to ensure that effective decision-making is preserved throughout, that will be in the best interests of members.

SPS512 requires RSE licensees to submit a preliminary assessment with regard to their transition arrangements by 1 July 2016. Should the Bill not pass through the Parliament in 2015, the due date should be extended to allow funds sufficient time to think through these complicated issues. Similarly, the date for submission of the full transition plan should be subject to the date of Royal Assent.

**AIST submits** that the date for the preliminary assessment on transition be amended to 1 July 2016 or six months from Royal Assent, whichever is the later. The final transition plan should then be due six months from that date.

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## 4 Conclusion

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AIST supports strong governance practices and is committed to developing better practice models where evidence suggests that better outcomes for members can be achieved. However, AIST does not believe that the aims of the legislative package fixes any existing deficiency in the system, and nor do we believe that the Bill and supporting prudential standards and practice guides will result in meeting those stated objectives.

AIST strongly urges APRA to reconsider some of the prescriptive proposals we have identified in our submission, and restructure these requirements in a principles-based context. The over-emphasis in the draft SPS510 and SPG510 on independence, while reflecting a current Government priority, overstates the importance of this consideration. This may impede the efficient operation of superannuation funds, and may increase rather than reduce risk.

AIST strongly urges APRA to make sure it has the balance right with regard to all of the important considerations for good governance practices and individual director attributes in its prudential framework and the proposed new arrangements.