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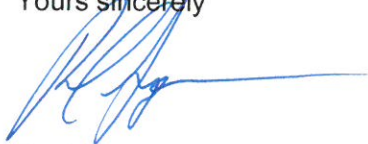
Dear Sir/Madam

Financial System Inquiry Final Report

Enclosed is the submission of TWU Nominees Pty Ltd, the Trustee of the TWU Superannuation Fund, to the Financial System Inquiry.

Please contact Lachlan McBain on (03) 9635 5960 or at lachlan_mcbain@twusuper.com.au if you have any questions.

Yours sincerely



Paul Sayer
Chief Executive Officer

Enc.

Submission to Financial System Inquiry

Outline

TWU Nominees Pty Ltd, the Trustee of the TWU Superannuation Fund (TWUSUPER) welcomes the opportunity to make this submission.

TWUSUPER was established in 1984 as Australia's industry super fund for the transport industry. With over 30 years of experience in delivering strong services and investment performance for our members and employers, TWUSUPER now has over \$4 billion in assets, 122,000 members and 14,000 employers and is Australia's largest industry super fund for the transport and logistics sector.

TWUSUPER is considered the super fund of choice for some of Australia's largest transport companies.

Our specific comments are limited to Recommendations 10, 12 and 13 of the Inquiry's final report. Otherwise, we support the submissions made to the Inquiry by the Australian Institute of Trustees and Industry Superannuation Australia.

Recommendation 10 – Improving efficiency during accumulation

Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.

The Trustee supports a formal, open and transparent competitive process for new MySuper members and believes this is already achieved through the selection process used by the Fair Work Commission (FWC). The Trustee does not support "auctioning" or tendering" of MySuper products. The Trustee also does not support the other alternatives considered by the FSI involving the removal of the FWC's legislated role in selecting fund approved lists for award employees or imposing additional requirements on MySuper authorisations, such as fee caps.

The Trustee agrees with the submissions made by AIST¹ and ISA² for the selection of default funds to remain part of the industrial relations process.

Specifically, the Trustee supports maintaining the current selection process used by the FWC, an independent body, as an appropriate system to achieve the public policy objective of having in place a cost effective system that ensures employees (and particularly disengaged employees) have their superannuation entitlements invested in a high quality MySuper default product.

The FWC selection process of default funds was significantly enhanced by 2012 amendments to the *Fair Work Act 2009*. These changes came into effect on 1 January 2014. The strengths of these revised arrangements can be broadly summarised as follows:

- The selection process has been made more open, transparent and objective;

¹ AIST submission *Response to the Financial System Inquiry Interim Report* dated 26 August 2014

² Industry Super Australia submission *Financing Australia's Growth – Submission to the Financial System Inquiry* dated 31 March 2014

- The process is clearly focused on ensuring that only quality MySuper products, with strong long-term net return performance are named or retained in awards. Under the new selection criterion, the FWC must consider matters such as investment return, fees and costs, governance practices, insurance offered and administrative efficiency of the fund's MySuper product;
- The assessment process is undertaken by an Expert Panel of the FWC that includes members approved by the Government with expertise in finance, investment management and superannuation;
- The new process supports competition since any superannuation fund with a default MySuper product can apply to be selected to be named in awards and the selection process is based on objective criteria;
- The list of approved default funds that can be included in awards is limited to a maximum of 15 funds, which is a manageable number from which employers can choose a default fund.

The Trustee agrees with the proposition that there needs to be a "quality filter" to ensure that the MySuper products listed in modern awards represent what is in the best interests of employees. For reasons mentioned above, the Trustee submits that the newly enhanced and transparent FWC selection process would successfully meet this objective. The Trustee therefore strongly urges the Government to appoint a new member to the Expert Panel as soon as possible so that the FWC is able to perform this role.

We also note that many submissions raised concerns with the proposed "auctioning" and "tendering" process and in particular we refer to the submissions made by the AIST and ISA in this regard. The Trustee shares these concerns and accordingly does not support this part of the recommendation.

Finally, as has been pointed out in the submissions referred to above, it is too early to change the newly introduced MySuper regime. The industry has recently finished implementing significant and costly changes and it would be inappropriate to start planning for further significant change.

Recommendation 12 – Choice of fund

Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.

Superannuation entitlements are an important part of employment terms and conditions and the Trustee is of the view that it is in its members' best interests for these arrangements to be part of the industrial relations landscape. It is therefore appropriate that superannuation entitlements continue to be governed by enterprise agreements.

The enterprise agreement determination of a dedicated MySuper product for employees promotes the benefits of efficiency and scale for super savings of that group. These benefits potentially include group insurance arrangements, where allowing employees to choose other superannuation funds could jeopardise automatic acceptance cover and place upward pressure on premiums.

The Trustee also notes that workers have a vote on enterprise agreements and this “is a fairly effective, collective choice that is being exercised”.³ Without enterprise bargaining, vulnerable employees of the organisations concerned may run the risk of having inferior or inappropriate superannuation vehicles imposed upon them by their employer.

The Trustee further submits that the current system of naming superannuation funds in enterprise agreements appropriately addresses employees’ needs. As an industry fund, TWUSUPER has been designed to reflect the demographics of its membership, taking into account the context of the particular industries in which its members work. Accordingly, such funds are designed with the best interests of their particular constituent members in mind.

To the extent that some employees may prefer their superannuation assets to accrue in a different fund, they can exercise portability by regularly transferring the balance of their funds (subject to any mandated minimum retention amount) to that other fund.

Recommendation 13 – Governance of superannuation funds

Mandate a majority of independent directors, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.

The Trustee supports having in place a governance structure that encourages effective decision-making processes in the best interests of beneficiaries. The Trustee believes the current equal representation model, where the Board has the option of appointing independent directors, together with the increased governance requirements introduced by the Stronger Super reforms, supports this objective. The Trustee is concerned that mandating board composition may seriously compromise what has proven to be an effective approach without any clear empirical evidence to support the benefit of the proposed changes (and when such evidence as is available may lean towards supporting the opposite conclusion – refer under ‘*Independent directors do not lead to better performance*’ below).

We understand that the FSI’s main concern was to align superannuation governance with international best practice in corporate governance. However, we do not agree with this rationale as it ignores a fundamental difference between corporate governance and superannuation governance.

In corporate governance the shareholder is the key stakeholder and the main governance focus is to ensure that the company is managed in the best interest of shareholders. Much of corporate governance is concerned with managing agency risk, being the risk that the interests of managers may not be aligned with those of shareholders and, as a consequence, managers may take action that benefit themselves at the expense of shareholders. Board composition, and in particular the

³ The then Minister for Revenue and Assistant Treasurer in the Coalition Government, Senator Helen Coonan, endorsed the status of default funds named in enterprise agreements in speeches made to Parliamentary during the passage of the choice of fund legislation (Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2003) - Senate Hansard, 22 June 2004, p24547.

presence of a majority of independent directors, has become an important control measure for ensuring that management acts properly and in the best interests of shareholders.

By contrast, the focus of superannuation trustees is to act in the best interests of beneficiaries and, where there is a conflict, to give priority to the interests of beneficiaries. This focus is reinforced by the trust structure and the fiduciary duties to members that flow from it. The key stakeholders of superannuation arrangements are members and employers, not shareholders. The equal representation model allows these key stakeholders to be involved in the decision making process. It is this alignment of interests between board members and key stakeholders that facilitates an effective decision making process in the interests of members. Imposing an arbitrary board structure involving independent directors, thereby diluting the influence of member and employer representatives, would seriously damage and undermine an effective governance model that has proven to serve members well, precisely because the interests of directors are already aligned with members. Also, because all directors are necessarily external to management, objective oversight is inherent in an equally represented board's composition. Hence, with the equal representation model, no further structural 'control' is necessary.

Benefits of the equal representation model

The current equal representation model allows (but does not require) an independent director to be included on the board, where it is considered that the presence of an independent would enhance the composition of the board, for example, by bringing particular skills and experience. The Trustee supports this flexibility.

Another advantage of equally represented boards that could be lost with an arbitrary independent director requirement is the diversity of thinking and perspective that is a common attribute of the equal representation model, when compared to most corporate boards.

It should also be noted that superannuation has a fundamental occupational nexus that makes the current equal representation model for trustee boards highly appropriate, as has been the experience in the governance structures of occupational pension funds in most OECD countries.⁴

Independent directors do not lead to better performance

The Trustee refers to the ISA⁵ and AIST⁶ response to the Government's discussion paper *Better regulation and governance, enhanced transparency and improved competition in superannuation* and particularly to the information supporting the following points:

- There is no conclusive study to show that independent directors add value;
- Boards with equal representation have demonstrably achieved better investment returns than other funds;

⁴ See 2008 OECD Working Paper on Pension Fund Governance

⁵ *In Members' Best Interests - ISA Submission to the Government Discussion Paper* dated 12 February 2014.

⁶ AIST discussion paper dated February 2014

- As referenced above, OECD research shows that many other jurisdictions use equal representation for the governance bodies of occupational pension funds;
- Some academics argue that structural independence will not guarantee “independence of thought” because it does not take into account group dynamics or the behavioural traits of directors as individuals⁷. Research conducted by Peter Swan and David Forsberg⁸ on listed companies concluded that between \$30 billion and \$50 billion of shareholder value in the top 200 companies listed on the Australian Securities Exchange was lost between 2001 and 2012 on account of independent board directors. The research found that independent directors had a negligible stake in the business, which diminishes any intrinsic incentive to monitor, and often had no specific knowledge or background in the industry, owing to their part-time status.⁹

The Trustee would also point out that many prominent corporate failures in recent years, such as Enron, WorldCom and HIH Insurance had independent boards with qualified individuals. This illustrates that having independent directors, of itself, does not guarantee good governance and effective decision making.

Stronger Super Reforms have significantly enhanced governance requirements

As mentioned above, the governance arrangements for superannuation funds have recently been significantly enhanced, at great cost and expense to the industry and members. The new requirements have introduced new competency requirements, including for Board members¹⁰, enhanced obligations to identify and proactively manage conflicts of interests and duties, both for the trustee as an entity and for directors personally¹¹, board renewal processes and annual board performance assessments¹².

In addition, the Stronger Super reforms also introduced new duties and obligations on trustees and directors,¹³ as well as increased their exposure to potential liability to members for loss. Trustee directors now have the highest exposure to liability of any category of directors in Australia, which will serve as a strong incentive for directors to act prudently in accordance with the new requirements.

The cumulative impact of these changes provides a further safety net in ensuring effective decision making by the boards. In light of these changes, and given the unique nature of the superannuation environment, the Trustee believes that the equal

⁷ S Wheeler, ‘Independent directors and corporate governance’ (2012) 27 *Australian Journal of Corporate Law* 168; D. Walker “A Review of Corporate Governance in UK Banks and Other Financial Entities” 2009 (Walker Report).

⁸ PL Swan and D Fosberg, “Does Board ‘Independence’ Destroy Corporate Value?”, UNSW working paper (2014)

⁹ PL Swan and D Fosberg, above, p7

¹⁰ SPS 520 Fit and Proper and SPS 520 Governance

¹¹ *Superannuation Industry (Supervision) Act 1993*, ss 52(2)(d) and 52A(2)(d), with SPS 521 Conflicts of Interests

¹² SPS 520 Governance.

¹³ Superannuation trustees and directors must meet the objective standard of care and diligence of a professional trustee making investments on behalf of beneficiaries; see SIS Act s 52(2)(b) and 52A(2)(b). This is a higher standard than for corporate directors, where the standard of care and diligence is partially subjective. In addition corporate directors have the benefit of a business judgment defence: see *Corporations Act 2001*, s180.

representation model remains the most appropriate governance model for superannuation arrangements.

Changes to the definition of “independent”

The Trustee would support refining the current definition of “independent” in section 10 of the SIS Act, which is primarily framed around achieving independence from other representative bodies. Hence the current definition of independence precludes an independent director from being a member of the fund. The Trustee would support removing the exclusion of members of the fund from being considered as “independent” but otherwise considers that the current definition of “independent” in section 10 of the SIS Act is generally appropriate for equal representation boards.

The Trustee also considers that the ASX corporate governance principles, which focus on independence from management and key service providers, could be included in APRA guidance. The primary modification to these principles required to reflect the unique nature of superannuation arrangements would be to remove the references to substantial shareholding, given that the shares in most occupational superannuation trustee companies are of nominal value and their constitutions do not enable the shareholder to influence the composition of the board.

If you have any questions about this submission, please direct enquiries to Lachlan McBain, TWUSUPER Chief Governance Officer, on (03) 9635 5960 or at lachlan_mcbain@twusuper.com.au.