CORPORATE SUPER ASSOCIATION

ABN 97 799 893 065

PO Box 508
Collins Street West
MELBOURNE VIC 8007
Tel: 03 8319 4075
Email: corpsuper@netspace.net.au
Website: www.corsuper.com.au

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The Manager
Superannuation Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: StrongerSuper@treasury.gov.au

Dear Sir

DISCUSSION PAPER OF 28 NOVEMBER 2013: BETTER REGULATION AND GOVERNANCE, ENHANCED TRANSPARENCY AND IMPROVED COMPETITION IN SUPERANNUATION (THE DISCUSSION PAPER)

The Corporate Superannuation Association provides comment as follows.

BACKGROUND: THE CORPORATE SUPERANNUATION ASSOCIATION

Established in 1997, the Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors. The Association represents a total of 27 funds controlling $75 billion in member funds. In general, these funds are sponsored by corporate employer sponsors with membership restricted to employees from the same holding company group, but we also include in our membership a few multi-employer funds with similar employer involvement and focus, as well as some master funds with divisions for separate employer-sponsors.

Throughout this submission, we refer to all these funds as "corporate funds."

Many of our member funds have trustee bodies with equal representation through director appointments from employers and employees.

PRELIMINARY: EQUAL REPRESENTATION MODEL AND OTHER BOARD ARRANGEMENTS

We see the following distinct situations:

- Funds with equal representation where an employer group appoints the employer representative and member representatives are appointed by election by the members (referred to below as "member elected equal representation");
- Funds with equal representation where the employer and member representatives are appointed as nominees of industry bodies, unions and other groups;
- Other arrangements.

Distinct situation of funds where member representatives are appointed by election

There is a distinction between the situation where equal representation requirements are met by appointees chosen by employer and industry bodies (such as unions); and the situation where the fund membership directly elects representatives.

Where union or other bodies nominate board directors, there is a distance between the membership and the director. The director will have a relationship with the body that appointed him or her and not directly to the membership. Hence he or she will be relatively remote from the membership's interests. The argument for independent directors in this situation is more persuasive, in order to reduce conflicts of interest.

In contrast, where the employer group (being related to each other) nominates employer representatives and member representative directors are appointed by direct election from the membership, we do not believe that it is necessary, in order to avoid conflicts, to appoint any independents, given that conflict of interest is unlikely to arise amongst the member representatives. In this situation the interests of the representatives (who are usually members of the fund) are aligned.

Contrast of corporate funds with public offer and other funds with diverse membership

The situation of corporate sponsored funds differs radically from that of funds (such as retail funds and large publicly offered funds) where membership is drawn from individual members and disparate employers. It is hard for the interests of such disparate members and employers to be represented on a board, as there are so many members and employers and they do not necessarily have common interests. The funds they belong to are large and very complex. The role of the trustee director with specialist skills, as well as the director with an independent and objective view, is clearly important in such funds.

The situation for corporate funds differs from that of large funds with diverse membership. As noted in the Discussion Paper, the representation of the interests of employees and employer remains an important focus for the trustee in corporate funds. There is a reservoir of deep knowledge of the fund, of the employers' operations and of the employees' situations within these groups. Newly appointed directors bring new objectivity, but also participate in the pooled knowledge and skills. There are benefits in the participation of the interested employer and employee parties.

Moreover, such funds typically engage specialist advisers who are selected having regard to their skills and experience. They have not developed internal resources of a scale that compromises their ability to change the way the fund operates.

RESPONSE TO FOCUS QUESTIONS

Governance

2 What is the most appropriate definition of independence for directors in the context of superannuation boards?

Board requirements

The presence of independent directors may assist with:

- avoiding conflicts;
- enhancing objectivity; and

- providing specialist skills.

In the context of equal representation, a person may be appointed to a board as an "independent" where that person is not an employer or an employee representative but brings particular skills to the Board. In this context, if the only requirement is the enhancement of specialist skills on the board, the level of "independence" from employer and members is not important. In practice in our funds, we see a range of situations, from those where there is no connection with employer or employees, to situations where the person has been a former employee or office holder of fund or employer, or an advisor.

On the other hand, where the primary requirement is the avoidance of conflicts of interest, the independence from interested groups does become important.

We believe that the attributes of independent trustees of corporate funds with member-elected directors under member elected equal representation, differ from those desirable in the director/trustees of public offer funds and in funds with a form of equal representation where the member representatives are appointed by industry bodies. Where the member elected equal representation model applies, the need for "independent" directors would arise only in respect of acquisition of additional board skills.

We do not believe that it is essential that such independent directors of corporate fund trustees should be completely independent of association with employer or employee groups, or of association with experts and advisors used by the fund, either currently or within any specified earlier time frame. We believe that to require complete freedom of association from employer, employees and advisors would deprive a corporate fund of a very useful pool of expertise. We believe that the focus should be on an appointment process involving skills needs assessment and the seeking of directors to meet those needs.

The *Superannuation Industry (Supervision) Act* (the ***SIS Act***) definition of "independent director" as a person who is not a member of the fund, an employee of an employer-sponsor or a representative of a trade union, appears to be appropriate for these requirements and could be supplemented by a requirement that the person appointed should meet skills needs assessments.

Hence, we would support a definition relevant to traditional equal representation funds which defined "independent" directors as those:

- appointed by a process separate from that applicable to employer and employee representatives, and
- through the application of criteria based on skills appropriate to the fund's needs.

Independence for directors of funds other than traditional equal representation funds

We support a definition which would require no current or former association with industry groups, including unions, that might give rise to conflicts of interest. Further, exclusion of directors employed by or related to advisors and service providers related to the employer is desirable, again to avoid conflicts.

We do not believe that it is necessary to exclude all employees and members, or experts and advisors used by the fund, either currently or within any specified earlier time frame.

We believe that to require complete freedom of association from employer, employees and advisors would deprive a fund of a very useful pool of expertise. We believe that the focus should be on an appointment process involving skills needs assessment and the seeking of directors to meet those needs; the avoidance of conflicts through the exclusions mentioned above is a further important requirement.

Comparison with banks and insurance companies

We note the comparisons made with APRA's requirements for the boards of banks and insurers. We stress that the governance situation for funds differs greatly from that applying in a bank or insurer.

It is important for a bank board or an insurer's board to avoid conflict with the interests of depositors and policy-holders. In addition, the risks faced are radically different. Banks and insurers run certain risks which do not concern the boards of superannuation funds, notably in relation to deposit ratios (in the case of banks) and in relation to exposure to underwriting risk (in the case of insurers). The major risks encountered, and the specialist skills required by directors of these entities, are thus very different from those affecting the boards of superannuation funds.

ASX listed entities

The ASX principles are valuable, and we note that in fact the SIS Act requirements are, in general, as stringent as those applying under the ASX model. However, we believe there is value in retaining the differences in respect of board composition. We note that the ASX model was a response to the dominance of executive and major shareholding directorships. It is rare for a superannuation fund CEO or Secretary to be a Trustee Director.

3 What is an appropriate proportion of independent directors for superannuation boards?

Funds with member-elected equal representation

For reasons set out above, we do not think there should be any mandating of independent directors on the board.

Other funds with equal representation

We have concerns about a hard and fast rule requiring one-third independent directors. The increase in independent directors could be at the expense of a loss of numbers of existing directors, with their knowledge of the fund and its membership. To take an example, a fund with a board of 9 directors, currently composed of 4 employer representatives, 4 member representatives, and 1 independent director, would be required (under a one-third rule) to appoint 2 more independents and to remove one each of the employer and employee representatives (or alternatively to appoint three more independents).

It is not clear that the members and employers will benefit as a result of the loss of knowledge in the Board of the fund, its membership and sponsors, and the costs of running the fund may well increase. We can envisage a situation where such a change is warranted where external skills on the Board will be of assistance, but we do not believe

that a hard and fast numbers rule is appropriate. We believe that it is preferable to base the requirement for independent directors on the skills requirements for the fund.

Other funds – without equal representation

In a fund without representation of members or employers on the board, we see the need for a range of skills in the director board and for the avoidance of conflicts.

Summary

In our view, the approach to independent director requirements should be along the following lines:

Type of Fund	Approach to Independent Director Requirements
Directly appointed and member-elected equal representation fund: member representatives directly elected by membership	Not required but optional if supplementary skills need identified for Board
Fund with equal representation provided by nomination of employer representative organisations and unions	Independent director(s) needed to provide required skills and to avoid conflicts
Other funds	Independent director(s) needed to provide required skills and avoid conflicts

4 Should superannuation trustee boards have independent chairs?

In our view, the crucial attribute for the Chair is that he or she should be well-qualified for the role in that he or she is:

- a fit and proper person; and
- competent to execute the role effectively.

For boards with equal representation, where the board is made up of an appropriate proportion of employee, employer and "independent" directors, the independence of the Chair is desirable but not essential.

5 Does it matter how independent directors are appointed?

Our comments on (5) and (6) below are restricted to the corporate fund situation.

As indicated under our responses above, we believe that the appointment of independent directors of funds with equal representation should be based on an assessment of skills and objectivity across the Board. The process of appointment should be based on this assessment once skills needs have been identified. Generally in our funds, the independent directors are appointed by the existing board members, and this seems to us to be an appropriate model.

6 Should the process adopted for appointing independent directors be aligned for all board appointments?

We do not believe that it is appropriate for corporate funds under a regime of equal representation to align the appointment process of employer or employee representative directors with that of independent directors. Our preference expressed above is for the independent directors to be appointed by the Board by reference to the complementary skill set they offer, to supplement the skills of the employer and employee representatives. For corporate funds, we do not believe it appropriate to disturb the appointment processes for employer and employee representatives which involves an agreed process set out in the trust deed or governing rules of actively nominating and electing or appointing a director.

7 Conflicts

See our response to Focus Question 2.

8 Maximum appointment term

We would be concerned about setting a maximum term, as this is a rigid format that does not necessarily result in an outcome that is in the members' best interest.

9 Regular appraisals

We support a regular review process, focusing on the demonstration of required competency and skills.

10 Implementation

We would support self-regulation for the implementation of governance changes in respect of the composition of trustee boards. However, we accept that APRA guidance in this area may be constructive, with an emphasis on flexibility depending on the fund's membership and needs.

Enhanced transparency

13 Choice product dashboard

In general our members support consistency between the information presented in the MySuper and Choice product dashboards.

However, where a member has opted for a Choice product, this indicates a willingness to examine the Product information in greater depth. Hence, disclosure of information more meaningful to the specific product, without compromising the simplicity of the product dashboard, should be allowed.

14 Return target

We note that there are Choice products where CPI-related objectives will not be realistic or even meaningful, and it may be more appropriate to use a more relevant index directly related to the type of investment. This will apply particularly where the Choice product involves a specific investment or a specific market area investment.

15 Net investment return

Both measures may be helpful to members, although ultimately a large portion of members simply want to know the actual (net) return and this forms the basis for their comparison across products and between funds.

We also accept that the "net return" measure has limited relevance and becomes less helpful for members with balances other than the "typical" $50,000. Members in Choice options may well find the net investment return measure more meaningful in terms of the product they have chosen. They are likely to review the information provided and appreciate that the amount excludes administration fees.

We support the disclosure of both measures for Choice products and believe that there is a good argument for the disclosure of both in relation to MySuper products as well (as this will assist members with balances significantly different from the $50,000 reference balance).

16 Longer term risk measure

We support the inclusion of a longer term risk measure for both MySuper and Choice dashboards. We believe that the additional complexity of including a measure other than a short-term volatility measure is outweighed by the benefits of providing the investor with insight into the anticipated longer term performance risk.

We believe that the measure proposed by the Institute of Actuaries as outlined in the Discussion Paper is reasonable, subject to using a reference index consistent with that used for the Return Target.

18 Liquidity measure

If this measure is used, the details would need to be agreed by the industry. The area is complex and there is a risk that the measure, and its explanation, may not be well understood by the user. If adopted, it would be essential to agree on at least two areas:

- a definition of what is meant by "liquid"; and
- the reference time frame within which liquidity is required.

20 Portfolio Holdings Disclosure

We agree that the current draft regulations are too onerous and raise practical difficulties and privacy issues. We support the alternative proposal which would require disclosure limited to that required to be reported to APRA under *Reporting Standard SRS 532.0: Investment Exposure Concentrations*. This has the advantage of coinciding with existing information disclosure, hence would reduce the additional compliance burden.

Enhancing competition in the default superannuation market

Focus questions 27 to 30

Given the stringent requirements for MySuper products, we do not believe it is necessary to apply further screening to products employers may nominate as default funds. It should be sufficient that the fund is a MySuper product.

We agree that as suggested under question 30, that it would be helpful to smaller employers to provide a non-mandated advisory list of high quality funds. We suggest that an expert panel within the Fair Work Commission should be well positioned to provide this list.

Focus question 31

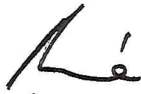
The retention of corporate funds as default funds in awards, including the retention through grandfathering, has been the result of various forms of bargaining and negotiations.

To exclude these funds will result in adverse results for members, because many provide benefits that exceed SG minimum, provide tailored and favourable insurance arrangements, and are otherwise generously supported by the employer-sponsor in a way that would not apply to an external fund.

In addition, there are corporate funds that are hybrid funds where the defined benefit interest does not (or may not in the future) meet the minimum requisite benefit requirements when the SG Rate increases. The accumulation interests in such funds may not be substantial so as to involve members have an investment choice.

Removal of these corporate funds from the default under the award, or inability for the employer to contribute for SG purposes generally, would disrupt the agreed arrangements, resulting in a need for extensive re-negotiations and dislocation. We consider this would be unlikely to be in the best financial interests of the members.

Yours faithfully



Mark N Cerché
Chairman
Corporate Superannuation Association