

CORPORATE SUPERANNUATION ASSOCIATION Inc.

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Manager
Insurance and Superannuation Unit
Financial System and Services Division
The Treasury
Langton Crescent
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Email: superannuationgovernance@treasury.gov.au

Dear Sir

REFORMS TO SUPERANNUATION GOVERNANCE

I refer to Treasury's invitation to the public to make submissions on the exposure draft legislation made public on 26 June 2015. The Corporate Superannuation Association provides comments below.

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 25 funds controlling \$65 billion in member funds, held in a total of 695,396 individual accounts. In general, these funds are sponsored by corporate employers, with membership restricted to employees from the same holding company group, but we also include in our membership several multi-employer funds with similar employer involvement and focus.

Given the nature of our funds and their corporate sponsorship, we feel strongly about the current proposals, which will result in very dramatic changes to the equal representation system. We have consistently defended this system, which continues to provide significant benefits to the members and sponsoring employers, because it provides a robust system of governance, with the interests of the interested parties balanced and safeguarded.

CORPORATE SUPER ASSOCIATION

The value of the existing form of self-governance in non-public offer funds was recognised in the Final Report of the Financial Services Inquiry. Recommendation 13 of that Inquiry, regarding independent directors, referred only to public offer funds. The Final Report also stated, on page 135:

In defined benefit schemes sponsored by a single employer, equal representation of employees and employers is appropriate and consistent with the governance models of defined benefit pension funds internationally. These funds would continue to operate using the structure for which equal representation was designed, with the employer bearing the financial risk from the board's decisions.

The Report then continued with an observation that

The equal representation model has less relevance in the current superannuation system, which predominantly consists of public offer DC funds and funds less focused on a single employer.

The above observation clearly points a distinction between public offer funds, and those funds sponsored by one or a restricted group of employers, like those of our membership.

We firmly believe that it would be valuable to the members of our funds and to the system at large to permit these funds to continue to operate successfully, in a way which preserves the interests of their members.

<p>We submit that all non-public offer corporate employer sponsored funds should be excluded from the proposed independence requirements and be allowed to continue to operate the equal representation trustee system.</p>

Governance issues and independence

Conflicts

The benefits of the equal representation system flow to members of non-public offer employer-sponsored funds through the involvement of members and employer representatives in the governing of the fund. Many years of experience of the fund's circumstances and condition, and of the employment arrangements, are handed down through these boards. The identification of the trustee representatives with those who are financially and otherwise interested in the fund is not, in these circumstances, a disadvantage. There is no problem of conflict, as none of the parties plans to profit from the fund other than through its benefits.

We see a clear argument for distinguishing the treatment of non-public offer employer-sponsored funds from that of public offer and retail funds. We agree that in the latter, the involvement of third-party independent trustees can minimise conflicts.

We re-iterate that we believe that the risk of conflict arises in certain types of funds only, and that trustee independence is a requirement that should be applied to those types of funds only.

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Additional skills

While independence is a characteristic that should be used to reduce risk of conflict, in other situations it is important to open the field to persons with skills appropriate to the needs of the particular fund. External talent may well bring much-needed specialist and other skills of experience to the table. However, we believe that the importation of additional skills is a benefit which must be distinguished from the independence criterion. There are many trustees currently in office under the equal representation system who bring very valuable internal knowledge to the table.

Independence

Additional expertise can and should be supplied whenever the trustee and employer-sponsor consider necessary. However, where there is an obligation to appoint independent directors, to make the paramount requirement a complete absence of connection with fund, employer and service providers will deprive the fund of a very useful pool of expertise.

Cost of implementing the independence requirements

In the equal representation system, employee and employer representatives are typically not remunerated for their efforts, other than as part of their general employment arrangements. The move to a significant number of independent directors, not only on the main board but on board committees, will create significant additional costs. Increased costs lead either to increased fees for members or to increased costs borne by employers who thus become further discouraged. Members lose out one way or another, because either their benefits are reduced through higher costs, or their employer-sponsor may withdraw involvement, close the fund, or otherwise withdraw previously generous support.

There is no indication that the additional costs associated with the proposed structure would bring compensating benefits for non-public offer funds. As indicated above, we find that our funds seek additional external skills as and when required, in a targeted way that assists the purposes of the particular fund.

To provide some examples, we find that a number of our funds do have independent chairs already, whilst others prefer to keep this role “in-house”. Continued interest of the employer-sponsor and avoidance of excessive formality are benefits of this approach.

Estimates of increased costs

One medium sized, long-established fund with \$670 million in assets and 3600 members, estimates base additional costs at \$150,000 per annum, an increase of 10% on administration fees. These costs cover only an independent chair and one additional independent director. The actual costs are likely to be more, given APRA’s approach to committees and its general view that “minimum 50% independent” is the target.

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Another long-established fund, with close to \$5bn in assets, has several external directors appointed to meet the fund's needs for expertise. Increased costs of an independent chair and another independent director are approximately \$160,000; remuneration committee and audit committee members, other than the Chair, will add \$35,000 to \$40,000 per committee member. Some existing personnel on the board and committees may not meet the proposed legislative requirements for independence, despite their value to and experience with the fund. The fund provides benefits peculiarly appropriate to the sector in which it operates, including specialist life and disability coverage difficult to obtain elsewhere.

Generally, we perceive that an independent chairman commands an estimated fee of \$100,000 per year, independent main board members \$50,000 to \$65,000, and committee members \$35,000 to \$40,000. Travel and accommodation expenses, for external directors, are additional costs. The introduction of paid board and committee members will create disparity in Boards. The disparity may also result in a push for remuneration of all trustees on the grounds of equity, resulting in significant further cost increases.

We stress that our funds are not opposed to expenditure where benefits accrue to members, but those funds are appalled at the prospect of spending members' money to reduce the efficiency of the current system.

As the senior executive of one of our member funds comments,

Apart from the cost, my biggest concern is about the significant change this will impose on the Trustee relationship with the Company. The Company pays the bills and gets very little in return apart from goodwill of employees and some (quite limited) flexibility in relation to managing DB surplus/deficits. The Chairman of the Trustee board has always been a senior Company appointee (e.g. Finance Director or HR Director) which simplifies any necessary communications between the board and Company. In practice, this has rarely been an issue anyway, as there is no interference from the Company (and none would be tolerated).

Imposing an independent Chair, in particular, will change the dynamic significantly, inevitably making the whole process more formal, and I struggle to see any realistic upside. The current six Directors are well qualified and had no trouble convincing APRA of that at the recent prudential review meeting.

Policy committees

We note that all provisions relating to policy committees are removed, under the proposed changes. Removal of equal representation requirements on policy committees would be consistent with the general removal of equal representation requirements from trustee boards. However, the complete abolition of policy committees would deprive members and employer-sponsors of public offer funds of the opportunity to represent views to the trustee. Policy committees currently provide a vital avenue to keep the employer engaged in an out-sourced fund.

We urge that, in any event, policy committees be retained in a form that permits this communication to continue.

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Difficulties for funds with boards of individuals

Aside from the anticipated difficulties in sourcing trustees for corporate trustee boards with appropriate background who meet the required criteria for independence, there is added difficulty sourcing independent trustees for a board made up of individuals, because of issues of liability and other concerns.

Inconsistent approach to “majority independence”

Draft legislation and regulations

We are concerned that the draft legislation contains an outright SIS Act requirement for one-third independent board members, but that the proposed Corporations Regulations require a fund to state in its Annual Report whether or not it has a majority on the trustee board independent of the RSE licensee, and if there is not such a majority, to declare its reasons. We believe that this would mislead members and the public. The implication is that there is a requirement for a majority and that the trustee must justify non-compliance. Clearly the trustee can justify an approach that complies with the one-third requirement without imposing the non-mandatory majority independence, but the need to justify puts the trustee on the back foot and is unreasonable.

APRA’s letter to trustees on proposed prudential standard

APRA’s letter of 26 June 2015 again reveals an inconsistency of approach. On the one hand, the draft legislation requires one-third independents on the main board of a trustee. On the other hand, APRA signals its intention to issue a prudential standard requiring:

- Majority independent members on board remuneration and audit committees;
- Independent chairs for the board remuneration and audit committees;
- Separate independent chairs for the main board and the board audit committee.

The proposed requirement for majority independent members on board committees produces a strange mismatch between SIS Act requirements regarding the main board, and prudential requirements regarding board committees.

The additional costs may be reasonable for a public offer fund, but we cannot see the benefit for the typical employer sponsored non-public offer fund, where conflicts are, as we have previously indicated, rarely an issue.

Conclusion

We acknowledge the benefit of some changes to strengthen the governance of the major public superannuation funds.

For non-public offer funds, however, the suggested changes will bring substantial additional cost without any clear benefit for members and we strongly urge you to reconsider the proposed “all funds” approach.

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We welcome further discussion on the above.

Yours faithfully



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