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## BILLS DIGEST

BILLS DIGEST NO. 40, 2017–18

12 OCTOBER 2017

# Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017

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Law and Bills Digest Section

## Contents

<b>The Bills Digest at a glance</b> .....	<b>3</b>
<b>History of the Bill</b> .....	<b>4</b>
<b>Purpose of the Bill</b> .....	<b>4</b>
<b>Structure of the Bill</b> .....	<b>4</b>
<b>Background</b> .....	<b>4</b>
Nature of governance.....	4
Governance of superannuation funds.....	5
Independent directors.....	5
Trustee governance arrangements.....	6
Policy development.....	6
Cooper Review.....	7
Government response to the Cooper Review.....	8
Coalition policy.....	8
Financial system review.....	9
Relevant consultation.....	9
2015 draft legislation.....	9
<b>Committee consideration</b> .....	<b>9</b>
Senate Standing Committee on Economics.....	9
Senate Standing Committee for the Scrutiny of Bills.....	10
<b>Policy position of non-government parties/independents</b> ...	<b>10</b>
<b>Position of major interest groups</b> .....	<b>10</b>
Support for the Bill.....	10
Opposition to the Bill.....	11
<b>Financial implications</b> .....	<b>11</b>
<b>Statement of Compatibility with Human Rights</b> .....	<b>11</b>

**Date introduced:** 14 September 2017

**House:** The Senate

**Portfolio:** Treasury

**Commencement:** the day after Royal Assent

**Links:** The links to the [Bill](#), its [Explanatory Memorandum](#) and [second reading speech](#) can be found on the Bill's home page, or through the [Australian Parliament website](#).

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the [Federal Register of Legislation website](#).

**All hyperlinks in this Bills Digest are correct as at October 2017.**

Parliamentary Joint Committee on Human Rights .....	11
<b>Key issues .....</b>	<b>11</b>
Is mandating for independence necessary? .....	11
Arguments for the measures.....	12
Arguments against the measures.....	12
Trustee arrangements for pension funds overseas.....	13
Does an ‘independent’ board improve performance? .....	13
<b>Schedule 1—key provisions.....</b>	<b>15</b>
Repeal of equal representation model.....	15
Independent directors or trustees and an independent Chair.....	16
Meaning of ‘independent’ .....	16
Stakeholder comment.....	17
Determinations of independence .....	17
Application and transitional provisions .....	18
<b>Schedule 2—key provisions.....</b>	<b>18</b>
<b>Concluding comments .....</b>	<b>18</b>

## The Bills Digest at a glance

### Purpose of the Bill

The purpose of the Bill is to implement a board governance structure for certain superannuation funds that requires at least one third of trustee directors to be **independent** and that the chair also be independent.

### Background

The inclusion of independent directors on the board of listed companies emerged in corporate governance policy in the early 1990s in Australia, with corporate principles developed by the Australian Stock Exchange (ASX) including that boards comprise a majority of independent directors and that the chair should be an independent director.

The 2009–10 Cooper Review of superannuation endorsed mandating that one third of directors be ‘non associated’ directors and the 2014 Murray Report on the financial system supported mandating for a majority of ‘independent’ directors and an ‘independent’ chairperson on superannuation fund boards.

### Key elements

The Bill repeals the existing provisions of the *Superannuation Industry (Supervision) Act 1993* that establish the equal representation model and replaces them with the following requirements:

- the chair of the **registrable superannuation entity** (RSE) licensee’s board of directors must be independent from the RSE licensee (for RSE licensees that are a body corporate)
- at least one third of the RSE licensee’s directors or trustees must be independent from the RSE licensee
- the RSE licensee must comply with any requirements of the prudential standards in relation to the appointment or removal of directors who are independent from the RSE.

The meaning of **independent from an RSE licensee** includes conditions under which a person is excluded. These encompass limits on shareholding interests (subject to certain exclusions) and require minimum periods to have elapsed since the person had a business relationship with the RSE licensee or trustee that was material, or since the person was employed by certain related entities.

The regulator—the Australian Prudential Regulation Authority (APRA)—will be empowered to develop prudential standards and also make determinations about whether or not a person is considered **independent from an RSE licensee**.

### Stakeholder concerns

The policy reasons for the measures proposed by the Bill are contested—although there is general agreement about the importance of good governance at a board level to entity performance.

There are differing views about whether requirements for independent trustee members and an independent chair should be mandated or expressed in general principles which individual boards can choose to implement.

### Key arguments

The main arguments for the measures proposed by the Bill broadly relate to the general acceptance of the principle that independent board members and chairpersons bring improved decision making processes, a greater diversity of skills, and experience which will contribute to both strengthening the superannuation system overall as well as member interests.

The main arguments against the measures proposed by the Bill include that the existing equal representation model has performed well; the model is an important feature of the superannuation system and is prevalent in many overseas pension funds; and that there is a lack of evidence to support the changes as the imposition of a principles-based framework creates a lack of flexibility for boards and will lead to additional costs without any equivalent benefits.

## History of the Bill

The Superannuation Legislation Amendment (Trustee Governance) Bill 2015 (the first Bill) was introduced into the House of Representatives on 16 September 2015.<sup>1</sup> The Bill was passed by that chamber and was debated in the Senate on 25 November 2015 but did not progress. The first Bill lapsed when the Parliament was prorogued on 17 April 2016.

The Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 (the Bill) which was introduced into the Senate on 14 September 2017, is in near-equivalent terms to the first Bill—although some of the proposed amendments in the first Bill are not included.

A Bills Digest was prepared in respect of the first Bill.<sup>2</sup> Much of the material in this Bills Digest has been sourced from that earlier one.

## Purpose of the Bill

The purpose of the Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 is to amend the [Superannuation Industry \(Supervision\) Act 1993 \(SIS Act\)](#) and the [Governance of Australian Government Superannuation Schemes Act 2011](#) to require that certain superannuation funds have at least one third of directors or trustees that are **independent** from the licensee of the fund and that an **independent** director or trustee be chair of the trustee board.

The Bill provides for a three-year phase-in period for the requirements from the day of Royal Assent—except for those provisions relating to the Commonwealth Superannuation Corporation (CSC) which is the trustee of various Commonwealth superannuation schemes, which will apply to new board appointments after the commencement of the *Superannuation Laws Amendment (Strengthening Trustee Arrangements) Act*.

## Structure of the Bill

There are two Schedules to the Bill:

- Schedule 1 implements the changes to the *SIS Act*
- Schedule 2 broadly implements similar arrangements in relation to appointments to the CSC.

## Background

### ***Nature of governance***

The term ‘governance’ when used in relation to an organisation or business:

... encompasses the system by which an organisation is controlled and operates, and the mechanisms by which it, and its people, are held to account. Ethics, risk management, compliance and administration are all elements of governance.<sup>3</sup>

The terms ‘governance’ and ‘corporate governance’ are used interchangeably in relation to organisations although the term ‘corporate governance’ can have specific relevance to companies (as opposed to other forms of business and non-business organisations). The concept of governance at an organisation level has its roots in the development of corporations with the separation of ownership (shareholders) from control (management) and how to manage the principal-agent ‘problem’ that potentially arises due to the different interests of management and other stakeholders.<sup>4</sup>

Importantly, the concept of governance covers structural elements such as those that regulate how the management function is arranged (such as board functions and membership) and the duties and obligations of relevant people that are part of the organisation. It also covers elements that may not be able to be directly

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1. Parliament of Australia, ‘[Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015 homepage](#)’, Australian Parliament website.
  2. K Swoboda, [Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015](#), Bills digest, 40, 2015–16, Parliamentary Library, Canberra, 2015.
  3. Governance Institute of Australia (GIA), ‘[Governance foundations](#)’, GIA website.
  4. JJ du Plessis, A Hargovan and M Bagaric, [Principles of contemporary corporate governance](#), 2nd edn, Cambridge University Press, Cambridge, Vic, 2010, pp. 5–10.

regulated, such as the ensuring that the relevant people have appropriate skills and experience and a positive organisational culture.<sup>5</sup>

### **Governance of superannuation funds**

Superannuation funds in Australia are established under a ‘trust model’, whereby the trustee (which for superannuation funds is usually a company) has an obligation to act in the best interests of its members. The use of this trust model for superannuation funds is embedded in the *SIS Act*, with all APRA-regulated superannuation funds operating as trusts, usually with a company as the trustee.<sup>6</sup> The individual directors of the trustee company (sometimes referred to as the ‘trustee board’ with the individuals referred to as ‘trustee directors’) are required under the *SIS Act* to operate the fund in the best interests of members—given that the sole purpose of the superannuation system is to provide retirement benefits to members.<sup>7</sup> Added on to the trust model are the licensing arrangements in the *SIS Act*, which include adherence to relevant prudential standards covering a range of corporate governance issues such as conflicts of interest and risk management.<sup>8</sup>

### **Independent directors**

Interest in the concept of an *independent* (also referred to as a ‘non-executive’) board director emerged in the corporate governance literature in the 1980s and 1990s as greater recognition was given to the role played by board directors that were separate to management (who are referred to as ‘executive directors’ or ‘inside directors’) in bringing additional expertise to the decision making process as well as providing a check on self-interest and abuse within corporate management.<sup>9</sup>

The application of a broader policy to mandate requirements for the inclusion of independent directors on the boards of listed companies was included in a key UK governance review in 1992 (known as the Cadbury Review after its chair Sir Adrian Cadbury).<sup>10</sup> The Cadbury Review, commissioned at a time of increasing lack of investor confidence in the honesty and accountability of listed companies and by sudden financial collapses of some companies, supported minimum numbers of independent directors, with the concept of independence based on independence of judgement and independence of association:

Non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct. We recommend that the calibre and number of non-executive directors on a board should be such that their views will carry significant weight in the board’s decisions. To meet our recommendations on the composition of sub-committees of the board, all boards will require a minimum of three non-executive directors, one of whom may be the chairman of the company provided he or she is not also its executive head. Additionally, two of the three should be independent in the terms set out in the next paragraph.

An essential quality which non-executive directors should bring to the board’s deliberations is that of independence of judgement. We recommend that the majority of non-executives on a board should be independent of the company. This means that apart from their directors’ fees and shareholdings, they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. It is for the board to decide in particular cases whether this definition is met. Information about the relevant interests of directors should be disclosed in the Directors’ Report.<sup>11</sup>

In Australia, an emphasis on corporate governance policy arose in the early 1990s from a series of reports sponsored by the Business Council of Australia known as the ‘Bosch reports’.<sup>12</sup> Conducted at a similar time to the

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5. Ibid.

6. Review into the Governance, Efficiency, Structure and Operation of Australia’s Superannuation System, ‘*Review into the governance, efficiency, structure and operation of Australia’s superannuation system: final report, Part two: recommendation packages*’, [Super system review: final report], (Cooper Review), The Review, Canberra, June 2010, p. 44.

7. Ibid., p. 45.

8. Australian Prudential Regulation Authority (APRA), ‘[Superannuation prudential standards](#)’, APRA website. Adherence to the prudential standards is a requirement of Part 3A of the *SIS Act*.

9. Du Plessis et al, op. cit., p. 110.

10. Committee on the Financial Aspects of Corporate Governance, [Report of the Committee on the Financial Aspects of Corporate Governance](#), (Cadbury Report), Gee, London, 1 December 1992, paragraphs 2.1 and 2.2.

11. Ibid., paragraphs 4.11 and 4.12.

12. Du Plessis et al, op. cit., p. 136.

Cadbury Review, the first Bosch report (published in 1991) included amongst the suggested principles for better corporate practices and conduct, that independent directors were important. However, rather than recommending any particular number of non-executive directors, the first Bosch report merely noted that it would be a useful safeguard to appoint at least two directors who have no personal or professional association with the company.<sup>13</sup> The second Bosch report, which took account of the Cadbury Review recommendations, was delivered in 2003. By that time, the suggestion that directors be independent was more prominent, with the preference that the majority of directors should be independent.<sup>14</sup>

The ASX's Corporate Governance Council published its [\*Principles of Good Corporate Governance and Best Practice Recommendations\*](#) in 2003.<sup>15</sup> ASX-listed companies were to adopt the best practice recommendations and, if not, to disclose 'why not'.<sup>16</sup> One of the best practice principles espoused by the ASX Corporate Governance Council was that 'a majority of the board should be independent directors'.<sup>17</sup> A further best practice recommendation was that 'the chairperson should be an independent director'.<sup>18</sup> The most recent version of the *ASX Principles of Good Governance and Best Practice Recommendations*, released in 2014 (third edition), has retained this approach.<sup>19</sup> The ASX principles, while not directly applying to superannuation funds, provide a useful framework against which to assess the specific requirements for the independence of superannuation fund trustee directors.

### **Trustee governance arrangements**

Under existing arrangements, the trustee of an APRA-regulated superannuation fund is known as an **RSE licensee** as it operates under a Registrable Superannuation Entity licence issued by the APRA under Part 2A of the *SIS Act*.<sup>20</sup> Part 9 of the *SIS Act* requires that the board of a corporate trustee for a standard employer-sponsored fund of five or more members must consist of equal numbers of employer representatives and member representatives—these are referred to as the **equal representation rules**. The boards of such RSE licensees may appoint an independent director if that is permitted under an RSE's governing rules and is requested by the employer or member representatives on the board.<sup>21</sup>

Superannuation fund trustees are subject to a broad range of governance requirements including a range of operating standards established in the *SIS Act* such as operating standards that form part of licensing conditions, specified covenants that are to be part of the governing rules of superannuation funds and prudential standards issued by APRA.<sup>22</sup>

### **Policy development**

The proposals included in the Bill have their origins in the recommendations of a review of the superannuation system conducted in 2009–2010.<sup>23</sup> While the recommendations relating to trustee board composition were

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13. Ibid., p. 138.

14. Ibid., p. 140.

15. Australian Stock Exchange (ASX) Corporate Governance Council, [\*Principles of good corporate governance and best practice recommendations\*](#), ASX, Sydney, March 2003.

16. Ibid., p. 5.

17. Ibid., recommendation 2.1, p. 19.

18. Ibid., recommendation 2.2, p. 21.

19. ASX Corporate Governance Council, [\*Corporate governance principles and recommendations\*](#), 3rd edn, ASX, Sydney, 2014, pp. 17–18.

20. Under section 10 of the *SIS Act* the term **RSE licensee** means a constitutional corporation, body corporate, or group of individual trustees, that holds an RSE licence granted under section 29D.

21. APRA, [Submission](#) to the Senate Economics Legislation Committee, *Inquiry into the provisions of the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, pp. 4–5.

22. Part 3 of the *SIS Act* provides that operating standards for regulated superannuation funds may be prescribed in regulations that may cover issues such as the number of trustees and the composition of boards and committees and the disclosure of information about funds to the Regulator. Covenants to be included in the governing rules of registrable superannuation entities are specified in section 52 of the *SIS Act* and include a covenant for each trustee to act honestly in all matters concerning the entity and to perform the trustee's duties and exercise the trustee's powers in the best interest of the beneficiaries. Prudential standards are established under Part 3A of the *SIS Act*. Standards established to date cover issues such as conflicts of interest and outsourcing. See APRA, ["Superannuation prudential standards"](#), APRA website.

23. Australian Government, ["Review into the governance, efficiency, structure and operation of Australia's superannuation system: papers"](#), Super System Review website.

largely rejected by the Gillard Government,<sup>24</sup> the Coalition's 2013 election policy was broadly similar to the provisions of the Bill.<sup>25</sup>

### Cooper Review

The 'Super System Review', (known as the 'Cooper Review' after its chair Jeremy Cooper), led to a number of important changes under the Gillard Government including the introduction of a low-cost default superannuation product ('MySuper'), efforts to improve the 'back office' efficiency of the superannuation system ('Superstream') and some changes to the regulation of self-managed superannuation funds (SMSFs).<sup>26</sup>

In terms of superannuation fund governance, the final report of the Cooper Review observed that trustee governance structures had not kept up with developments in the industry and that there had been difficulties for trustees and their trustee-directors in understanding what is expected of them.<sup>27</sup> The recommendations to improve governance arrangements included creating a distinct new office of 'trustee-director' with all statutory duties (including those which would otherwise be imposed by the [Corporations Act 2001](#)) to be fully set out in the *SIS Act*<sup>28</sup> and for an industry council to develop (with APRA coordination and in consultation with stakeholders) a 'Code of Trustee Governance' for trustees of superannuation funds and their trustee-directors to assist with identifying best practice in the industry.<sup>29</sup> It is important to note that in formulating its recommendations, the Cooper Review considered that the corporate governance arrangements that applied to ASX-listed companies were a 'reasonable starting point' for the arrangements that should apply to superannuation fund trustees 'given the profound impact the latter have on the retirement incomes of members'.<sup>30</sup>

In relation to the structure of the trustee board (the matters which are the subject of this Bill), the Cooper Review recommended that 'non-associated' trustee members be mandated as part of trustee boards:

- if a trustee board does not have equal representation, the trustee must have a majority of 'non-associated' trustee-directors<sup>31</sup> and
- for those boards that have equal representation because their company constitutions or other binding arrangements so require, the *SIS Act* should be amended so that no less than one third of the total number of member representative trustee-directors must be 'non-associated' and no less than one third of employer representative trustee-directors must be non-associated.<sup>32</sup>

The term 'non-associated' nominated by the Cooper Review was derived from the concept of independent directors on company boards. However, no clear definition of the term was provided, with the Cooper Review providing an outline of what the term would cover:

For this purpose, the term 'non-associated' would have a different meaning from the term 'independent' in the *SIS Act*. For example, the Panel believes that a member of the fund could be a 'non-associated' trustee-director. Non-associated trustee-directors would still need to be free of connections to, or associations with, employer sponsors, the appointor (other than by reason of the appointment itself), entities related to the trustee, employer groups, unions, service providers and should not be current or former executives of the fund or a related entity. Of course, if a non-associated trustee-director is paid for their duties as a trustee-director, the fee should be paid only from fund assets and not by any third party.<sup>33</sup>

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24. The Treasury, [Stronger super](#), Treasury, Canberra, December 2010.

25. Liberal Party of Australia and the Nationals, [The Coalition's policy for superannuation](#), Coalition policy document, Election 2013, p. 5.

26. A summary of some of the outcomes of the Cooper Review is included in K Swoboda, [Major superannuation and retirement income changes in Australia: a chronology](#), Research paper series, 2013–14, Parliamentary Library, Canberra, 2014.

27. Cooper Review, '[Part two: recommendation packages](#)', op. cit., p. 43.

28. Ibid., recommendation 2.1, p. 48.

29. Ibid., recommendation 2.18, p. 64.

30. Ibid., p. 44.

31. Ibid., recommendation 2.6, p. 55.

32. Ibid., recommendation 2.7, p. 56.

33. Ibid., p. 55. The term 'independent' is used in section 10 of the *SIS Act* to cover an **independent director** for a corporate trustee and **independent trustee**.

## Government response to the Cooper Review

The [Gillard Government response to the Cooper Review recommendations](#) (labelled as ‘Stronger Super’) was released on 16 December 2010.<sup>34</sup> In relation to the recommendations about the appointment of non-associated members to trustee boards, the Government did not support the proposals, considering that the composition of a trustee board was a matter for the board to determine.<sup>35</sup>

## Coalition policy

At the time of the release of the Cooper Review’s trustee governance recommendations and the subsequent Gillard Government response, the Coalition expressed its view that the Cooper Review recommendations about requiring independent directors to be appointed to boards should be implemented. The then Shadow Minister for Financial Services and Superannuation, Senator Cormann, noted in 2010:

The Minister shied away from outlining necessary reforms to improve corporate governance of superannuation funds and to ensure competition in the default fund market.

Where are the reforms for example to ensure mandatory disclosure of conflicts of interest, to require independent directors on superannuation fund boards, disclosure of director remuneration and directors of super funds to sit on a single fund and not hold multi-directorships.<sup>36</sup>

In August 2012, during the debate on a Bill that included provisions relating to trustee governance arrangements, Senator Cormann outlined how the Coalition viewed the recommendations of the Cooper Review and would amend the existing arrangements, should it be in government, to include ‘the appropriate provision of independent directors on superannuation fund boards’.<sup>37</sup>

In government, should we be successful at the next election, we will implement the sensible corporate governance reform recommendations made by the Cooper review that would see mandatory disclosure of conflicts of interest, the appropriate provision of independent directors on superannuation fund boards and which would force directors who want to sit on multiple boards and where there is clearly an apparent risk of conflict of interest to be required to demonstrate to APRA that they do not have in fact any foreseeable conflicts of interest. There is also the issue of conflicts of interest in relation to related party transactions that do need further tidying up when it comes to corporate governance standards.<sup>38</sup>

In the lead up to the 2013 election, the Coalition’s policy, although not specifically setting out what changes it would make if elected to government, questioned the equal representation model and stated that ‘the Coalition will work with all relevant stakeholders to ensure Australia’s superannuation system has appropriately high standards of corporate governance’.<sup>39</sup>

Following its election in 2013, the Coalition government circulated a consultation paper entitled, [Better regulation and governance, enhanced transparency and improved competition in superannuation](#), and sought feedback on some of the specific areas that are being proposed for change by the Bill, including:

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

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

Both the ASX Principles for listed companies and APRA’s requirements for banking and insurance entities either suggest or require an independent chair. Should superannuation trustee boards have independent chairs?<sup>40</sup>

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34. The Treasury, [Stronger super](#), op. cit.

35. Ibid., pp. 26–27.

36. M Cormann, [Shorten super statement short on detail and substance](#), media release, 26 October 2010.

37. M Cormann, [‘Second reading speech: Superannuation Legislation Amendment \(Trustee Obligations and Prudential Standards\) Bill 2012’](#), Senate, *Debates*, 14 August 2012, p. 5037.

38. Ibid., p. 5038.

39. Liberal Party of Australia and the Nationals, [The Coalition’s policy for superannuation](#), op. cit., p. 5.

40. The Treasury, [Better regulation and governance, enhanced transparency and improved competition in superannuation](#), Discussion paper, Treasury, Canberra, 28 November 2013, pp. 12–13.

## Financial system review

In addition, the 'Financial system review' (known as the '[Murray Report](#)' after the chair of the review, former CEO of the Commonwealth Bank David Murray AO)<sup>41</sup> delivered its [final report to the Government](#) in December 2014. The Murray Report arguably went further than the Cooper Review in that it recommended a majority of directors be independent and also that the chair be independent.<sup>42</sup> In making this recommendation, the Murray Report observed:

[i]ncluding independent directors on boards is consistent with international best practice on corporate governance. Independent directors improve decision making by bringing an objective perspective to issues the board considers. They also hold other directors accountable for their conduct, particularly in relation to conflicts of interest.<sup>43</sup>

## Relevant consultation

### 2015 draft legislation

On 26 June 2015, then Assistant Treasurer, Josh Frydenberg, proposed that all APRA-regulated superannuation funds, including corporate, industry, public sector, and retail funds, have a minimum of one third independent directors on their trustee board and an independent chair.<sup>44</sup> His announcement coincided with the release of draft legislation covering matters included in the Bill.<sup>45</sup> Twenty-seven submissions were received during the consultation period.<sup>46</sup> Subsequently Treasury noted that there had been a number of 'refinements' included in the first Bill such as:

- clarifying that the independent chair is not in addition to the one-third share of independent directors
- more detail and a revised definition of **independent** including amendments to the term 'substantial shareholding' and
- inserting a regulation making power that will specify circumstances that would result in a person being either independent or not independent.<sup>47</sup>

## Committee consideration

### Senate Standing Committee on Economics

The Bill has been referred to the Senate Standing Committee on Economics (Economics Committee) for inquiry and report by 23 October 2017.<sup>48</sup>

The first Bill was also referred for inquiry and report to the Senate Standing Committee on Economics (first Economics Committee).<sup>49</sup> In that case, the majority of the first Economics Committee recommended that the Bill be passed.<sup>50</sup> However, the Australian Labor Party (Labor) members of the first Economics Committee dissented, recommending that the first Bill not proceed.<sup>51</sup> The rationale for this view was, in part, that it would 'impose highly prescriptive changes, coupled worryingly with an ambiguous definition of independence'.<sup>52</sup>

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41. Financial System Inquiry (FSI), '[Home: the panel](#)', FSI website.

42. FSI, [Financial System Inquiry: final report](#), (Murray Report), Treasury, Canberra, November 2014, p. 133.

43. *Ibid.*, p. 134.

44. J Frydenberg (Assistant Treasurer), [Improving superannuation governance](#), media release, 26 June 2015.

45. The Treasury, '[Reforms to superannuation governance](#)', Treasury website.

46. The Treasury, '[Submissions to Treasury consultation on reforms to superannuation governance](#)', Treasury website.

47. The Treasury, [Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015 and associated regulation: Governance arrangements for registrable superannuation entities summary of consultation process](#), pp. 3–4.

48. Details of the terms of reference, submissions to the Economics Committee and the final report (when published) are available on the [inquiry homepage](#).

49. Details of the terms of reference, submissions to the Economics Committee and the final report are available on the [inquiry homepage](#).

50. Senate Standing Committee on Economics, [Superannuation Laws Amendment \(Trustee Governance\) Bill 2015 \[Provisions\]](#), The Senate, Canberra, 9 November 2015, p. 22.

51. *Ibid.*, p. 28.

52. *Ibid.*, p. 24.

## Senate Standing Committee for the Scrutiny of Bills

At the time of writing this Bills Digest the Senate Standing Committee for the Scrutiny of Bills (Scrutiny of Bills Committee) had not commented on the Bill.

Whilst the Scrutiny of Bills Committee included comments in relation to the first Bill in its *Alert Digest* of 14 October 2015, the comments related to provisions which are not included in this Bill.<sup>53</sup>

## Policy position of non-government parties/independents

Labor did not support the first Bill. In debate in the House of Representatives, some of the reasons given for this position include:

- the equal representation model for industry funds has performed well relative to other parts of the industry<sup>54</sup>
- a ‘one-size fits all’ governance model is not appropriate for superannuation funds which should be able to appoint independent directors if they think it is in the best interest of the fund rather than this being imposed by a prescriptive approach<sup>55</sup> and
- the changes will impose significant costs on fund members.<sup>56</sup>

The Australian Greens (the Greens) did not support the first Bill. In debate in the House of Representatives, Adam Bandt noted several reasons for opposing the proposed changes including the absence of ‘glaring’ governance problems in superannuation funds.<sup>57</sup>

At the time of writing this Bills Digest no contemporaneous comment had been made about the Bill. However, given that it is near-identical terms to the first Bill it is likely the views expressed by both Labor and the Greens about the first Bill will remain unchanged and so apply to this Bill.

## Position of major interest groups

At the time of writing this Bills Digest, major interest groups had not commented on this Bill. Major interest groups, including those in the superannuation industry, peak union and business groups and others expressed different views on the merits of the proposals included in the first Bill.

## Support for the Bill

Key interest groups that indicated their support for the first Bill included the Financial Services Council (FSC),<sup>58</sup> the Association of Superannuation Funds of Australia (ASFA),<sup>59</sup> the Australian Chamber of Commerce and Industry (ACCI),<sup>60</sup> the Australian Institute of Company Directors (AICD)<sup>61</sup> and the consumer group Choice.<sup>62</sup> The broad view of these groups was that the measures included in the first Bill would strengthen the superannuation system and protect consumers.

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53. Senate Scrutiny of Bills Committee, *Alert digest*, 11, 14 October 2015, p. 36.

54. L Chesters, ‘[Second reading speech: Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015](#)’, House of Representatives, *Debates*, 20 October 2015, p. 11779.

55. G Brodtmann, ‘[Second reading speech: Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015](#)’, House of Representatives, *Debates*, 20 October 2015, p. 11830.

56. J Chalmers, ‘[Second reading speech: Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015](#)’, House of Representatives, *Debates*, 19 October 2015, p. 11647.

57. A Bandt, ‘[Second reading speech: Superannuation Legislation Amendment \(Trustee Governance\) Bill 2015](#)’, House of Representatives, *Debates*, 20 October 2015, p. 11834.

58. Financial Services Council, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 30 September 2015.

59. Association of Superannuation Funds of Australia, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

60. Australian Chamber of Commerce and Industry, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

61. Australian Institute of Company Directors, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

62. Choice, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

## Opposition to the Bill

Key interest groups that opposed the measures included in the first Bill included the Australian Institute of Superannuation Trustees (AIST),<sup>63</sup> Industry Super Australia (ISA),<sup>64</sup> the Corporate Superannuation Association<sup>65</sup> and the Australian Council of Trade Unions (ACTU).<sup>66</sup> In general, these groups questioned the need for the proposed arrangements given the performance of the equal representation model.

The Australian Industry Group (AIG) and National Seniors Australia supported the provisions in the first Bill that mandate one-third independent directors but did not support the requirement that the chair be an independent director.<sup>67</sup> The broad rationale for not supporting the requirement that the chair be independent was that the board is best placed to decide who has the skills and capacity to fulfil the role of chair.

The Governance Institute of Australia did not support the first Bill. Instead, it recommended a non-prescriptive approach to governance be taken.<sup>68</sup>

A number of industry groups made specific recommendations on aspects of the first Bill in their submissions to the first Economics Committee inquiry into the Bill and in submissions to previous consultation processes on governance issues. Some of these are discussed in the key issues and provisions section below.

## Financial implications

According to the Explanatory Memorandum to the Bill, its financial impact on the Government will be nil.<sup>69</sup>

However, the compliance cost impact is estimated to be \$8.5 million in start-up costs and a further \$12.3 million in ongoing costs annually.<sup>70</sup>

## Statement of Compatibility with Human Rights

As required under Part 3 of the [Human Rights \(Parliamentary Scrutiny\) Act 2011](#) (Cth), the Government has assessed the Bill's compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible.<sup>71</sup>

## Parliamentary Joint Committee on Human Rights

At the time of writing this Bills Digest, the Parliamentary Joint Committee on Human Rights (Human Rights Committee) had not commented on the Bill.

The Human Rights Committee considered that the first Bill did not raise human rights concerns.<sup>72</sup>

## Key issues

### *Is mandating for independence necessary?*

The threshold question to address in debate about the provisions of the Bill is whether certain superannuation funds should have specific governance requirements in relation to the composition of the trustee board to require one-third independent trustee directors and an independent chair. Arguments for and against the proposal canvas a number of issues including the appropriateness of mandating a specific model, the financial

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63. Australian Institute of Superannuation Trustees, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

64. Industry Super Australia, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

65. Corporate Superannuation Association, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 5 October 2015.

66. Australian Council of Trade Unions, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

67. Australian Industry Group, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 2; National Seniors Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 15 October 2015, p. 2.

68. Governance Institute of Australia, [Submission](#) to the Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015.

69. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 7.

70. *Ibid.*

71. The Statement of Compatibility with Human Rights can be found at pages 30 and 61 of the [Explanatory Memorandum](#) to the Bill.

72. Parliamentary Joint Committee on Human Rights, [Twenty-ninth report of the 44th Parliament](#), 13 October 2015, p. 2.

costs in adopting new governance arrangements for the funds involved and the potential benefits to the sector and fund members of such changes.

### Arguments for the measures

One of the main arguments for the measures proposed by the Bill relates to the general acceptance of the principle that independent board members and chairs bring 'different skills and expertise and they can hold other directors accountable for their conduct, particularly in relation to conflicts of interest'.<sup>73</sup> To support this view, the Government points to the conclusions drawn by the Cooper Review and the Murray Report that the approach is consistent with international best practice on corporate governance.<sup>74</sup> These broad arguments are supported by a number of major interest groups including the FSC, ACCI, the Council of Small Business Associations of Australia and consumer group Choice.<sup>75</sup> The FSC notes:

The minimum standard of governance provided for in the Bill will protect consumers from circumstances where the judgement of non-independent directors may be influenced by the interests of a subset of the membership, a shareholder or a sponsoring organisation.

Arguments that the reforms are not necessary because funds with no independent directors have a track record of good investment performance misrepresent the purpose of the reforms. The focus of the reforms is governance and the behaviour of boards, not investment performance. All superannuation funds, be they retail, industry, public or corporate funds, have the capacity to improve their governance process.<sup>76</sup>

### Arguments against the measures

The main arguments against the measures proposed by the Bill include:

- that the equal representation model has performed well
- the equal representation model is an important feature of the superannuation system and is prevalent in many overseas pension funds
- there is a lack of evidence to support the changes
- the imposition of a principles-based framework will create a lack of flexibility for boards and lead to additional costs without any equivalent benefits.<sup>77</sup>

The AIST sums up many of these arguments, noting:

The lack of evidence to support governance changes highlights a significant flaw in this proposed reform process. Regulated superannuation funds are a major contributor to the Australian economy, with the not-for-profit superannuation sector representing more than \$650 billion in funds under management. While good governance practices should be encouraged and pursued at all times, AIST submits that mandatory changes to board composition will mean significant changes to the culture of these large financial institutions and disruption to fund activities, without any evidence of the need for such reform, or an articulated benefit to the members. These

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73. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 9.

74. *Ibid.*, p. 12.

75. Financial Services Council, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 30 September 2015, p. 2; Australian Chamber of Commerce and Industry, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 3; Council of Small Business Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 1; Choice, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 1.

76. Financial Services Council, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, *op. cit.*, p. 2.

77. Industry Super Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 42; Australian Institute of Superannuation Trustees, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 4 October 2015, p. 7; McKell Institute, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, p. 1, 1 October 2015.

changes will also come at a substantial cost (both through implementation and ongoing higher director fees) - to be borne by the members.<sup>78</sup>

### ***Trustee arrangements for pension funds overseas***

Governance arrangements for pension funds overseas provide some reference for the changes proposed by the Bill. It is important to distinguish between arrangements applying to corporations generally and those applying to pension funds in particular.

As noted earlier, support for a corporate board to comprise a majority of independent directors and an independent chair gained momentum in governance reviews in the 1990s and 2000s and these requirements are now established in key governance documents such as the ASX's *Principles of Good Corporate Governance and Best Practice Recommendations*. A summary of board independence requirements by the Organisation for Economic Co-operation and Development (OECD) concluded that almost all jurisdictions had introduced a requirement or recommendation with regard to a minimum number or ratio of independent directors—three jurisdictions (India, Hungary and the United States) had introduced a binding requirement for a majority independent board, while the others had taken a 'comply or explain' approach.<sup>79</sup>

The Explanatory Memorandum notes arrangements in Canada and the United Kingdom for corporations where it is recommended that a majority or at least one-half of boards should be comprised of 'unrelated' or 'independent' directors.<sup>80</sup> Importantly, individual companies in Canada and the United Kingdom are not required to implement such a structure but are only required to report about adherence to such a principle.<sup>81</sup>

A 2015 report by Mercer on the governance of superannuation (pension) funds examined the prevalence of independent directors on pension funds across a number of countries.<sup>82</sup> This research found that in nearly all OECD countries, boards for occupational pension arrangements are comprised of an equal number of employer and employee representatives but that this approach needed to be considered in the context of the different legal framework operating in many OECD countries, when compared to Australia.<sup>83</sup> Possibly the most relevant to Australia, given the use of the trust model, are arrangements in the United Kingdom for defined contribution schemes that require a majority of independent trustees or a majority of non-affiliated trustees depending on the type of scheme.<sup>84</sup>

### ***Does an 'independent' board improve performance?***

There is a broad economics-based literature on the relationship between good governance practices and firm performance, with studies examining the relationships between structural governance practices such as board size, independent directors, independent chairs, use of sub-committees and other matters and performance as measured by profitability and share price.

In general, these studies have found mixed results on the impact of independent directors on firm performance.<sup>85</sup> A 2010 review of empirical literature on the effects of independent directors on firm performance found that there was no strong evidence about the presence of a majority of independent directors:

...the notion that firm performance improves with the presence of a majority or supermajority independent directors on the board of firms is yet to have conclusive evidence. In fact, a good number of the studies point to the

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78. Australian Institute of Superannuation Trustees, [Submission](#) to Senate Economics Committee *inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, op. cit., p. 7.

79. Organisation for Economic Co-operation and Development (OECD), [Corporate governance factbook](#), OECD, Paris, March 2015, pp. 70–79.

80. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 41.

81. Toronto Stock Exchange (TSX), [Corporate governance: a guide to good disclosure](#), TSX, Toronto, n.d., p. 6; Financial Reporting Council, [The UK corporate governance code](#), The Financial Reporting Council, London, April 2016, p. 10.

82. Mercer, [Governance of superannuation funds: a report on independence requirements for trustee boards](#), Mercer Consulting (Australia), Sydney, May 2015.

83. *Ibid.*, p. 16.

84. *Ibid.*, p. 19.

85. See, for example, S Ferris and S Yan, '[Do independent directors and chairmen matter? The role of boards of directors in mutual fund governance](#)', *Journal of Corporate Finance*, 13(2–3), 23 February 2007; G Vintila and S Gherghina, '[An empirical investigation of the relationship between corporate governance mechanisms, CEO characteristics and listed companies' performance](#)', *International Business Research*, 5(10), 3 September 2012, pp. 175–191.

fact that the presence of more executive directors on the board positively affects firm performance than can ever be contemplated under a board with majority or supermajority independent directors. In the same vein some studies clearly point out that in some instances, the presence of independent directors makes positive firm performance impossible.<sup>86</sup>

More relevant to the provisions of this Bill are studies that have examined the impact of independent directors on the performance of superannuation (or 'pension') funds.<sup>87</sup> These include:

- a 2008 study of US public sponsored pension plans over the period 2001–2005 on the impact of outside or independent trustees on investment performance. The study found no relationship between board composition and characteristics and investment performance as measured by the excess return of the fund but that 'board composition plays an important role in plan funding status and asset allocation decisions'<sup>88</sup>
- a 2012 study of defined contribution funds in Poland over the period 1999–2010 found a positive correlation between the number of outsiders on the board and the pension unit return. The study also found that other characteristics such as the age or the education of the board members or the Chairman may be important<sup>89</sup>
- a 2013 study of the influence of various governance arrangements including the proportion of independent directors on superannuation funds trustee boards in Australia for 2009 and 2012. The study found that there was a beneficial impact of independent directors on industry fund boards but that this relationship was negative for retail funds and concluded that 'the beneficial impact of independent directors on [i]ndustry [fund] boards gives great weight to the Cooper recommendation for appointment of one-third independent directors'<sup>90</sup>
- a 2015 study of the relationship of between various governance arrangements and fees for not-for-profit superannuation funds between 2009–10 and 2010–11. The study concluded that the relationship for board independence had mixed results and the results from the analysis were insignificant.<sup>91</sup>

Industry groups aligned with the industry superannuation funds argue that industry funds have outperformed retail funds. They consider that there is no empirical evidence that the changes proposed in the Bill would improve the performance of affected funds.<sup>92</sup>

As part of its 2012 examination of default fund arrangements, the Productivity Commission noted that the equal representation model has generally operated well to date, but that some arguments for an equal representation structure become less compelling as funds actively broaden their membership beyond their traditional base.<sup>93</sup> At that time, the Productivity Commission did not support mandating a particular governance structure:

The Commission considers that issues relating to board structure are important. However, overall, there is a lack of compelling evidence to suggest that any one model of board structure should be viewed as clearly preferable in all cases. Therefore, the Commission does not consider it appropriate at this time for a particular structure to be mandated. Further, the Commission would not want to see restrictions placed on board structures without such restrictions having a sufficient evidentiary basis, particularly given the potential impact they could have on competition for default listing.<sup>94</sup>

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86. R Chibuike Iwu-Egwuonwu, '[Some empirical literature evidence on the effects of independent directors on firm performance](#)', *Journal of Economics and International Finance*, 2(9), September 2010, p. 196.

87. The term 'pension fund' is used in some countries to describe retirement savings funds that are broadly equivalent to superannuation funds in Australia.

88. J Harper, '[Board of trustee composition and investment performance of US public pension plans](#)', Rotman International Centre for Pension Management, Toronto, February 2008, p. 1.

89. O Kowalewski, '[Corporate governance and pension fund performance](#)', *Contemporary Economics*, 6(1), 2012, p. 41.

90. E Torunn Nisbet, '[Influence of board structure on the performance and governance framework of Australia's superannuation funds](#)', APRA, Sydney, December 2013, p. 33.

91. M Tan and M Cam, '[Does governance structure influence pension fund fees and costs? An examination of Australian not-for-profit superannuation funds](#)', *Australian Journal of Management*, 40(1), 2015, p. 131.

92. Australian Institute of Superannuation Trustees, '[Submission](#)' to Treasury, *Exposure draft for reforms to superannuation governance*, p. 9, 23 July 2015; Industry Super Australia, '[Submission](#)' to Treasury, *Exposure draft for reforms to superannuation governance*, 23 July 2015, p. 9.

93. Productivity Commission (PC), '[Default superannuation funds in modern awards](#)', Inquiry report, 60, PC, Canberra, 5 October 2012, pp. 100–101.

94. *Ibid.*, p. 102.

## Schedule 1—key provisions

Part 9 of the *SIS Act* contains governance arrangements relating to the composition of the trustee of a superannuation fund. As stated above, the **equal representation rules** which are currently in place provide for equal representation of employer and member representatives and allow for the appointment of an additional independent trustee or additional independent director.<sup>95</sup>

The terms **independent director** and **independent trustee** are defined in the *SIS Act* so that the director or trustee is not a member of the fund, is not an associate nor an employee of an employer or employee sponsor of the fund and is not in any capacity a representative of a trade union or other organisation representing the interests of the fund members or employee sponsors.<sup>96</sup> Non-adherence to the equal representation rules may result in a fund being directed not to accept any contributions made to the fund by an employer sponsor.<sup>97</sup>

Appointing more than one independent director to funds with equal representation boards requires the fund to apply for an exemption to the *SIS Act*.<sup>98</sup> The equal representation rules also provide some additional requirements under the [Superannuation Industry \(Supervision\) Regulations 1994](#) for a decision by the trustee board to be valid only where at least two-thirds of the total number of directors voted for it.<sup>99</sup>

**Item 1** of Schedule 1 to the Bill repeals and replaces Part 9 of the *SIS Act*. The new Part 9 contains the substantive elements of the changes that will require at least one third of trustees to be **independent** and for the chair to be **independent**. To that end it includes a list of circumstances in which a person will be **independent** for the purposes of the new Part 9.

### **Repeal of equal representation model**

The new Part 9 does not include any reference to the equal representation model. However, according to the Explanatory Memorandum to the Bill:

... the Australian Government's policy still allows representation of employer and employee groups on superannuation boards. The composition of superannuation trustee boards, beyond the one-third independent directors prescribed, will remain at the discretion of the board (subject to any requirements set out in the constitution of the trustee and to the overarching legal requirement that board members are fit and proper and that boards have an appropriate skill mix).<sup>100</sup>

The removal of the equal representation model is opposed by several stakeholder groups including AIST and ISA.<sup>101</sup> In particular AIST argued:

... both a member and an employer voice in a mandatory savings system are vital and that it should be preserved in all sectors of the APRA-regulated superannuation industry. The representative model ensures a deep knowledge of the membership, representation of their respective interests in a mandatory system, and proper consideration of all relevant issues in the pursuit of the best possible outcomes for members.<sup>102</sup>

The retention of the model for the remaining two-thirds of the board was supported by ASFA, who noted some potential unintended consequences such as a superannuation fund board comprising one-third independent directors and two-thirds employer representatives (meaning members would have no direct representation on

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95. *SIS Act*, section 89.

96. *Ibid.*, section 10.

97. *Ibid.*, section 87.

98. APRA, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 4.

99. [Superannuation Industry \(Supervision\) Regulations 1994](#), regulation 4.08.

100. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 42.

101. Industry Super Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 5; Australian Institute of Superannuation Trustees, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 4.

102. Australian Institute of Superannuation Trustees, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, op. cit., p. 14.

the trustee board) or two-thirds member representatives (meaning employer groups would have no direct representation).<sup>103</sup>

### ***Independent directors or trustees and an independent Chair***

**Proposed section 86** of the *SIS Act* provides that the Chair of the RSE licensee's board of directors must be independent from the RSE licensee (for RSE licensees that are a body corporate), that at least one third of the RSE licensee's directors or trustees must be independent from the RSE licensee (the Chair is included in meeting the one-third requirement) and that the RSE licensee must comply with any requirements of the prudential standards relating to the appointment or removal of directors who are independent from the RSE.

The requirement for an independent Chair was not supported by AIG and National Seniors Australia who otherwise supported the one-third independent requirements. The rationale for this view is that the board is best placed to decide who has the skills and capacity to fulfil the role of Chair.<sup>104</sup>

### **Meaning of 'independent'**

**Proposed section 87** of the *SIS Act* lists the circumstances in which a person will be **independent** from an RSE licensee for the purposes of satisfying the independent director requirements in proposed section 86 as follows:

- first, a person is considered to be independent from an RSE licensee unless certain conditions—relating to a nominated shareholding interest in the RSE licensee ownership arrangements and certain business and employment relationships with the RSE licensee—are present:
  - a specified nominated threshold limit of under five per cent shareholding interest (subject to certain exclusions) for an RSE licensee that is a body corporate in the share capital of the RSE licensee or in the share capital of the body corporate that is related to the RSE licensee<sup>105</sup>
  - a specified three-year minimum period has passed since the person had a business relationship with the RSE licensee or trustee that was material<sup>106</sup>—including a person who has been a director or executive officer of the RSE Licensee and a person who, as an employee had a business relationship with such a person<sup>107</sup>
  - at least three years have passed since the person was employed as a director or executive officer of the RSE licensee or a body corporate that is related to the RSE licensee<sup>108</sup>
  - if the RSE licensee is a group of individual trustees, three years have passed since the person was a director or executive officer of an employer-sponsor of the fund who is a large employer or an organisation (representing the interests of one or more employer-sponsors or representing the interests of members of the fund) that has the right to appoint directors or trustees of the RSE licensee<sup>109</sup>
- second, there is a regulation-making power under which a person falls within the meaning of **independent** if certain circumstances apply<sup>110</sup> and
- third, APRA may determine, under a process outlined in **proposed sections 88 and 89**, whether a person is independent from an RSE licensee or not.<sup>111</sup>

The use of specific thresholds of three years and a shareholding interest of five per cent to determine independence from ownership, business and employment arrangements are broadly similar to the *ASX Principles*

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103. Association of Superannuation Funds of Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 13.

104. Australian Industry Group, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 14 October 2015, p. 4; National Seniors Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, 15 October 2015, p. 2.

105. *SIS Act*, **proposed paragraphs 87(1)(a) and (b)**.

106. *Ibid.*, **proposed paragraph 87(1)(d)**.

107. *Ibid.*, **proposed paragraphs 87(1)(e)**,

108. *Ibid.*, **proposed paragraphs 87(1)(c)**.

109. *Ibid.*, **proposed paragraphs 87(1)(f)**.

110. *Ibid.*, **proposed subsection 87(3)**.

111. *Ibid.*, **proposed subsection 87(4)**.

of *Good Corporate Governance and Best Practice Recommendations* and the Financial Services Council's *FSC Standard No. 20 Superannuation Governance Policy*.<sup>112</sup>

A key term used to establish these thresholds relates to circumstances that are 'material' to a business relationship that the person or RSE licensee may have had—a circumstance that the Explanatory Memorandum notes will depend on the facts in each case.<sup>113</sup>

The regulation-making power is included 'to determine circumstances in which a person is considered independent regardless of the circumstances in section 87(1)'.<sup>114</sup> The rationale for the power is to 'allow APRA to respond to situations where a person's circumstances and their capacity to exercise independent judgement is clear but for reasons such as timing, restructures and mergers and acquisitions'.<sup>115</sup>

### Stakeholder comment

A number of views have been expressed by major interest groups on the overall drafting of the independence requirements. In particular AIG considers that the provisions of **proposed paragraph 87(1)(f)(i)**, which prescribes that a person would not be independent if they were, or had in the previous three years been, an executive officer or director of an employer-sponsor who employs more than 500 members of the fund, would 'impose ongoing compliance costs or, more likely, give rise to a reticence to appoint to the boards of large funds current or recent directors or officers of domestic organisations with large numbers of employees'.<sup>116</sup>

The Governance Institute of Australia considers that 'any strictly prescriptive definition will inevitably lead to difficulties' and that 'now is the time to step back and have a discussion about the governance outcomes for superannuation funds that should be sought'.<sup>117</sup>

### Determinations of independence

**Proposed sections 88–89** of the *SIS Act* create a process whereby APRA may determine an application by an RSE licensee that a person is independent from the RSE licensee. APRA may also make a determination of its own volition that a person is not independent.<sup>118</sup>

In making a determination under **proposed sections 88 and 90**, APRA is required to take into account the terms of **proposed section 87**—that is, the circumstances that prevent a person from being independent as well as the circumstances prescribed by regulations. Despite a person being deemed **not** independent because of the terms of proposed section 87, APRA may determine that they **are** independent provided that APRA reasonably believes that the person is likely to be able to exercise independent judgement in performing the role of director or trustee of an RSE.<sup>119</sup>

APRA has indicated that it expects to use the power in **proposed section 90** (determination that a person is not independent) infrequently on the basis that 'the legislative definition should provide sufficient information to undertake a robust assessment of a director's independence in most circumstances'.<sup>120</sup>

Decisions under **proposed sections 88 and 90** are **reviewable decisions**.<sup>121</sup> This means that a person affected by a decision under either of those sections may request APRA to reconsider the decision as well as seek review by the Administrative Appeals Tribunal.

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112. ASX Corporate Governance Council, *Principles of good corporate governance and best practice recommendations*, op. cit., p. 20; Financial Services Council (FSC), *FSC standard no. 20: superannuation governance policy*, FSC, Sydney, 26 March 2013, p. 10. These two documents refer to the definition of 'substantial holding' in section 9 of the *Corporations Act 2001* which includes voting interests of five per cent or more of the total number of votes attached to voting shares in the body, or interests in the scheme.

113. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 20.

114. *Ibid.*, p. 21.

115. *Ibid.*

116. Australian Industry Group, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, op. cit., p. 4.

117. Governance Institute of Australia, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, op. cit., p. 1.

118. *SIS Act*, **proposed section 90**.

119. [Explanatory Memorandum](#), Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017, p. 22.

120. APRA, [Submission](#) to Senate Economics Committee, *Inquiry into the Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, op. cit., pp. 8–9.

121. **Item 6** of Part 2 in Schedule 1 to the Bill amends the definition of **reviewable decision** in subsection 10(1) of the *SIS Act*.

## Application and transitional provisions

**Part 3 of Schedule 1** to the Bill provides for a transitional period for existing funds of three years after the date of Royal Assent.<sup>122</sup> During that time, if an RSE licensee complies with transitional prudential standards made by APRA neither the new governance provisions in Part 9 of the *SIS Act* nor the current provisions in Part 9 will apply. The transitional prudential standards override any contradictory provisions in trust deeds and other rules governing a regulated superannuation fund, including the constitution of a corporate trustee.<sup>123</sup>

This effectively provides for a period of three years for trustee boards to change their composition.

## Schedule 2—key provisions

The provisions of Schedule 2 to the Bill apply similar arrangements to the Commonwealth Superannuation Corporation (CSC). The CSC is the trustee for a number of Commonwealth public sector superannuation and military superannuation funds including the:

- Commonwealth Superannuation Scheme (CSS)
- Military Superannuation and Benefits Scheme (MilitarySuper)
- Public Sector Superannuation Scheme (PSS)
- Public Sector Superannuation accumulation plan (PSSap)
- Defence Force Retirement and Death Benefits Scheme (DFRDB Scheme)
- Papua New Guinea Scheme (PNG Scheme).<sup>124</sup>

Under the *Governance of Australian Government Superannuation Schemes Act* the CSC is comprised of a Chair and 10 other directors.<sup>125</sup> Currently, three of the other directors are nominated by the Australian Council of Trade Unions and two are nominated by the Chief of the Defence Force.<sup>126</sup> The Minister chooses the five other directors, but must consult with the Defence Minister before making the appointment.<sup>127</sup>

The Chair of the CSC is appointed by the Minister after agreement is given by the Board.<sup>128</sup>

The amendments in **Schedule 2** to the Bill to the *Governance of Australian Government Superannuation Schemes Act* provide for similar independence requirements as will be applied to superannuation funds by the amendments in Schedule 1 to the Bill.

**Items 1 and 2** operate so that a person is **independent from CSC** if the person satisfies the provisions of section 87 of the *SIS Act* as amended by the Bill.<sup>129</sup> Those directors who are not nominated by the Australian Council of Trade Unions or the Chief of the Defence Force must be **independent from CSC**.<sup>130</sup> In that case, **item 3** provides that such an appointment is not invalid if, after the appointment, the person ceases to be **independent from CSC**.<sup>131</sup> **Item 4** inserts a consequential amendment to expand the available reasons for the Minister to terminate the appointment of a director to include that they have ceased to be independent from CSC.<sup>132</sup>

## Concluding comments

The policy reasons for the measures proposed by the Bill are contested. While there is general agreement about the importance of good governance at a board level to entity performance, there are differing views about whether requirements for independent trustee members and an independent Chair should be mandated or expressed in general principles which individual boards can choose to implement.

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122. **Item 23** of Part 3 in Schedule 1 to the Bill.

123. **Items 24 and 25** of Part 3 in Schedule 1 to the Bill.

124. Commonwealth Superannuation Corporation (CSC), '[Your superannuation trustee](#)', CSC website.

125. [Governance of Australian Government Superannuation Schemes Act 2011](#), subsection 11(1).

126. *Ibid.*, subsection 11(2).

127. *Ibid.*, subsection 12(4).

128. *Ibid.*, subsection 12(5).

129. *Ibid.*, **proposed subsection 12(4A)**.

130. *Ibid.*, **proposed subsection 12(4)**.

131. *Ibid.*, **proposed subsection 12(7)**.

132. *Ibid.*, **proposed subsection 17(5A)**.

There are also different views as to whether the success of the equal representation model, under which superannuation funds can choose to appoint independent members or even Chairs to their boards, will be affected by the changes proposed by the Bill. At one end of the spectrum, the measures proposed by the Bill can be viewed as a pragmatic response to a general move towards appointing more independent members to such boards—one which some funds are already implementing. However, others argue that the success of the equal representation model is an important part of the superannuation system and that there is little evidence that the changes proposed by the Bill are required or desirable.

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