Governance Institute of Australia

T +61 2 9223 5744 F +61 2 9232 7174
E info@governanceinstitute.com.au
Level 10, 5 Hunter Street, Sydney NSW 2000
GPO Box 1594, Sydney NSW 2001
W governanceinstitute.com.au

12 February 2014

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

By email: superannuationconsultation@treasury.gov.au

Dear Senator Sinodinos

Better regulation and governance, enhanced transparency and improved competition in superannuation: Discussion paper

Governance Institute of Australia (previously Chartered Secretaries Australia) is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members hold primary responsibility within listed and unlisted entities for developing governance policies, ensuring compliance with the Corporations Act and ASX Listing Rules and supporting the board on all governance matters. Their familiarity with the practical aspects of how to implement best practice governance frameworks and ensure sound reporting to members has informed the comments in this submission.

Governance Institute of Australia welcomes the opportunity to comment on the discussion paper, *Better regulation and governance, enhanced transparency and improved competition in superannuation* (the discussion paper).

General comments: Aim for the best governance outcome

The superannuation industry has had a long and complex development. Any review of the superannuation system needs to take account of the changes that have occurred since compulsory superannuation was introduced in the 1990s.

At this time, employees usually had little or no choice in the superannuation fund of which they were a member. Nor did they usually have any say in the governance of the fund. The *Superannuation Industry Supervision Act 1993* (Cth) (SIS Act) required that the boards of employer-sponsored funds consist of equal numbers of employer and member representatives. However, the employer representatives were typically, in the words of the Act, 'nominated by a trade union, or other organisation, representing the interests of those members'. It was possibly not true in the 1990s and is even less true today that most members of employer-sponsored superannuation funds are members of trade unions. The members themselves should appoint and remove member representatives, not a trade union of which they are not a member and which does not represent their interests.

Similarly, when compulsory superannuation was first introduced, most funds involved defined benefit schemes in which the member received a pre-determined pension on retirement (usually calculated by reference to their final salary) and to the extent the assets of the fund were insufficient to fund the pension, the employer was required to make good any shortfall. In the circumstances, employers had a legitimate interest in the performance and good governance of the fund and could oversee this through appointing directors to the trustee.

Today, most employees are members of accumulation schemes in which the employee, not the employer, bears the risk of under-performance or poor governance in the fund. Employers have no legitimate expectation to appoint directors to the trustees of accumulation funds. As defined benefit funds disappear, so should the role of employers in the governance of superannuation funds.

The governance of employer-sponsored superannuation funds (as opposed to retail or for-profit funds) should be directly in the hands of those with the greatest stake in the performance of the fund — the members.

In the case of retail or for-profit funds, the members are essentially acquiring a service for a fee and, if they are dissatisfied with that service or the performance or governance of the fund, they can transfer their funds to another service provider. Members do not expect a significant say in the governance of retail funds any more than they expect a significant say in the governance of, say, a bank. Rather they rely on strict prudential regulation by APRA to ensure that their interests are properly protected.

Industry and other employer-sponsored funds are a different case. They are not offering a service for a fee. They are not seeking to generate a profit for an owner. They exist solely for the benefit of, and to protect the interests of, their members. The principal say in the governance of these funds should be in the hands of the members of the fund, not trade unions or employers.

There are also self-managed superannuation funds (SMSFs), where the members are often trustees.

It is now around the quarter century mark since the introduction of the Superannuation Guarantee Charge (SGC), which requires all employers to provide a set, minimum level of superannuation each year for each employee. The result is that the Australian workforce diverts a significant and increasing amount of its wages or salary into limited options for long-term investment that, with limited exceptions, cannot be accessed until retirement. The policy rationale of this compulsory system is twofold (and interconnected): to ensure that the employee acquires a ‘nest egg’ of savings to fund, at least partially, their retirement; and to reduce the financial load on the state to contribute to that retirement.

There is therefore a significant public interest in ensuring that our superannuation system is well managed and governed in order to fulfil these objectives. The employee forced to make their superannuation contributions, and the state which has to pick up any outcome shortfall, both have an interest in ensuring that the governance framework of superannuation entities is sound.

What is the best governance outcome?

Governance encompasses the system by which an organisation is controlled and operates, and the mechanisms by which it, and its people, are held to account. It encompasses transparency, accountability, stewardship and integrity. As a matter of good governance, therefore, there is merit in providing members directly with the final say in the governance of their superannuation fund. An example of a similar governance arrangement outside of superannuation is the manner in which members of a corporation (shareholders) have the right to appoint directors of the board and hold those directors accountable to them for the performance of the corporation.

Equal representation was an important aspect of the governance structure established by the SIS Act in 1993. As the government noted at that time: ‘One of the most important ways in which members are able to participate in the management and protection of their retirement savings is through representation on the board of trustees’. However, as noted above, employee representation through third parties such as trade unions is no longer automatically applicable due to the introduction of choice in superannuation — members of a fund are no longer all represented by the union. And unless an employer has a defined benefits scheme, where it retains responsibility for performance, there is no longer a reason to ensure employer representation on the board of trustees either directly or through third parties such as employer associations.

Furthermore, the representation of members through third parties introduces conflicts of interest, as the directors may have competing loyalties between the members of the superannuation entity to which they owe a primary duty and the organisations which they represent. Such situations present a risk, real or perceived, that directors may make decisions based on these external influences, rather than the best interests of members.[1]

Clearly, then, the best governance outcome would be to introduce a mechanism which allows members of the fund to appoint and remove directly the directors of the trustee and hold those directors accountable to members. That is, no one apart from members should have the decision-making power as to the appointment of directors. The special public purpose which superannuation plays also requires that directors be accountable as a matter of public policy. However, currently, this model does not generally exist.

Can governance practices from the corporate environment be applied in the superannuation system?

Governance Institute Members are of the view that the governance arrangements applied in the corporate environment cannot be transposed in their entirety to the superannuation industry, but that there are elements of the governance framework in corporations that should be considered, modified and applied to superannuation entities.

We support the view set out in the *Super System Review: Final Report* that:

> The governance standards that apply to major listed entities are a reasonable starting point for the requirements that should apply to trustees and their trustee-directors, given the profound impact the latter have on the retirement incomes of members. This is particularly so in light of the growing influence that super funds have in advocating corporate governance practices for entities forming part of their investment portfolios that are not necessarily matched in their own practices. Turning the governance spotlight on trustees’ own operations is, in the Panel’s view, critical to the long-term sustainability of the superannuation system.

The *Super System Review: Final Report* also notes that:

> Research in corporate governance generally shows that boards should be of an appropriate size and that boards that are too large can become ineffective and inefficient. Further, the Panel has been made aware that some trustee-directors seem to be appointed for an unlimited term and that turnover on the board rarely happens, or only happens for some trustee-directors and not others. Again, research shows that

[1] When this submission refers to ‘director’ we are referring to the person who serves as a director of a trustee company. The Super System Review (also known as the Cooper Review) report states that: ‘While it is possible under the SIS Act for a trustee to be a natural person, the vast majority of trustees of APRA-regulated funds are companies and it is the board of trustee-directors who are responsible for the trustee’s decisions and actions’.

succession planning and regular turnover on the board is important for good governance and new ideas.

Board composition, definitions of independence and management of conflicts of interest are components of a governance framework only. That is, the key governance outcome from which questions of board composition and management of conflicts of interest flow is to aim for greater empowerment to members and greater accountability of directors to members.

Governance Institute Members recommend that the key good governance outcome is to provide for members of defined contribution schemes to appoint directors of trustees and for those directors to be accountable to members. This provides a governance framework in which other questions of governance structure can be assessed and decided.

Our responses to the questions set out in the discussion paper are set out on the following pages of this submission.

We note that our recommendations are *not* intended to apply to:

- defined benefits schemes — our recommendations are intended to apply to defined contribution schemes, or
- SMSFs, which are currently supervised under a separate regulatory model.

We also note that there is a difference in the liability regimes attached to directors of a company and the trustees of a fund (directors have a fiduciary duty to act in the best interests of the company and trustees have a fiduciary duty to act in the best interests of members) and that this needs to be explored as part of the review of governance in superannuation entities.

Yours sincerely

Tim Sheehy
Chief Executive

Responses to questions in discussion paper

PART 1: A BETTER APPROACH TO REGULATION

Q1 The Government has committed to identifying (in dollar terms) measures that offset the cost impost to business of any new regulation. What suggestions do you have for how the regulatory compliance burden can be reduced?

Governance Institute strongly recommends using existing principles-based approaches to governance in place for listed entities and modifying them for application to superannuation entities as required rather than developing a new regulatory framework relating to the governance of superannuation entities. We provide further comment on this in Part 2.

PART 2: BETTER GOVERNANCE

Q2 What is the most appropriate definition of independence for directors in the context of superannuation boards?

Governance Institute is of the view that board composition is only one element in a governance framework. It is essential to ensure that there is director accountability to members, and the capacity for members to determine board composition in order to ensure that directors manage the fund in the best interests of members.

In relation to board composition, a central question in governance, which goes to the heart of accountability and stewardship, is: Who are you beholden to?

Governance Institute Members are strong supporters of independence as one of a number of indicators of director capability but we note that it is not the only indicator of director suitability or capacity. Importantly, board composition policy should require companies to have a mix of directors on the board with different skills and a robust board renewal plan should be in place.

We are a founding member of the ASX Corporate Governance Council (the Council), and have been involved in the development of the Council's *Corporate Governance Principles and Recommendations* since the first edition (2003). We have therefore been closely involved in the development of the indicators of independence set out in Box 2.1 in the Principles and Recommendations.

Based on our deep knowledge of the Council's Principles and Recommendations, we cannot agree with the statement in the discussion paper (page 11) that: 'The ASX Principles explicitly list factors that preclude directors from being independent'. It is important to note that independence of judgment may be affected by the indicators set out in Box 2.1, but that it cannot be assumed that independence of judgment is lost if some of those indicators are met. The indicators are examples of interests, positions, associations and relationships that may raise doubts about independence and require consideration, but they do not *prescribe* a loss of independence.

Also importantly, under the 'if not, why not' approach taken by the Principles and Recommendations, if an entity considers a Recommendation is inappropriate to its particular circumstances, it has the flexibility not to adopt it —- a flexibility tempered by the requirement to explain why to its shareholders.

Each ASX listed company is required under Listing Rule 4.10.3 to include in its annual report either a corporate governance statement that meets the requirements of that rule, or (under the proposed 3rd edition, due out in 2014 the URL of the page on its website where such a statement is located). The corporate governance statement must disclose the extent to which the company has followed the recommendations set by the ASX Corporate Governance Council during the reporting period.

Importantly, shareholders have the right to not elect or re-elect directors if they are unhappy with the explanation of independence provided in the corporate governance statement.

SIS Act definition

In relation to the current definition in the SIS Act, which describes independence as someone who is not a member of a fund, an employee of an employer-sponsor or a representative of a trade union, we note that various issues arise that render this an unsuitable approach to assessing independence. That is, while directors may appear to be independent according to this definition, upon examination, it can be seen that they are likely not to be independent. The issues arising include:

- a director cannot be a member of the fund of which they are a director, but they will be a member of another fund, and may find they have a conflict of duty. By comparison, we note that directors of public listed companies are encouraged to hold shares in the company, as this is seen to align their interests with those of shareholders — directors holding shares in the company on whose board they sit is not seen to affect independence
- directors of a superannuation fund may hold multiple and competing positions on the boards of other funds, and will likely find they have a conflict of duty
- the composition of various board committees may not necessarily reflect independence — the board committees could be comprised of the directors of the trustee or they could be comprised of only one director and internal appointees, that is, executive management. Such a committee would not be independent.

Governance Institute does not support the SIS Act definition of independence, for the reasons set out above.

ASX Corporate Governance Council definition

Governance Institute is of the view that the approach to independence set out in the Principles and Recommendations is best suited to application to trustee directors of superannuation entities. That is, boards would need to examine interests, positions, associations and relationships that may raise doubts about independence and, should any of those indicators be met, explain to members why the board considers that the director retains independence.

Board composition policy should require companies to have a mix of directors on the board with different skills and a robust board renewal plan should be in place. Importantly, therefore, members would require the right to appoint directors, which means they could choose not to elect or re-elect directors should they be unhappy with the explanation of independence concerning individual directors that the board provides.

If members are granted the right to elect — or not elect or re-elect directors — an independent director is essentially therefore one who has been elected by members, because members are of the view that the director is acting in their best interests.

To this end, **Governance Institute recommends** that the definition of independence found in the ASX Corporate Governance Council's Principles and Recommendations be adopted and applied, but that it would also need to be extended to include consideration of where a person is, or has been in the last three years:

- an employee or executive of an employer of members of the fund, or

- an employee or official of a trade union, or other organisation, representing the interests of members of the fund
- an employee of an employer association or body, representing the interests of the employer.

The appointment of employer representatives in the case of defined benefit funds would be permitted, but this would need to be reviewed regularly. For example, there are hybrid funds with defined benefit divisions which are a small proportion of the overall fund, that will become a still smaller proportion of the fund, as members leave the fund or retire. Permitting employer representatives to be appointed in such cases would not therefore achieve good governance outcomes.

Consistency in governance arrangements
To ensure a reduction in the compliance burden, and enhanced understanding of any compliance obligations, it is preferable that there be as much consistency as possible in both the use of definitions relating to governance and those governance arrangements that are put in place for superannuation funds.

Public listed companies have now had ten years to accustom themselves to the definition of independence provided in the Principles and Recommendations. Importantly, so have their institutional investors — the asset owners are superannuation funds. Superannuation funds therefore have a longstanding familiarity with the indicators of independence against which directors of public listed companies are held to account. Transposing the indicators of independence to the superannuation system is therefore not introducing new and unfamiliar definitions which will take time to understand.

Furthermore, the Australian Prudential Regulatory Authority (APRA) has previously taken the criteria for independence in the 2nd edition of the Principles and Recommendations and applied them as prescriptive criteria in the prudential standards applicable to banking and insurance institutions. It is likely that any amendments to the indicators of independence in the 3rd edition of the Principles and Recommendations will be set, in turn, as prescriptive criteria in the APRA prudential standards.

The result is that the ASX Corporate Governance Council's definition of independence is extremely well known and understood. However, Governance Institute is not supportive of the prescriptive manner in which APRA has applied the definition of independence, because it conflicts with the 'if not, why not' approach that has been so successful in changing governance practice and behaviour under the ASX Corporate Governance Council's guidelines.

Governance Institute recommends that alignment with the definition of independence in the Principles and Recommendations provides the consistency most suited to ensure a reduction in the compliance burden and enhanced understanding of compliance obligations. We note that a modification would need to be introduced to ensure that the definition covered representative appointees. However, we strongly recommend that this be applied on an 'if not, why not' basis, as it is in the ASX Corporate Governance Council's Principles and Recommendations.

Recommendations
Governance Institute recommends that:

- the ASX Corporate Governance Council's approach to independence be adopted and applied to superannuation entities, with the definition extended to cover representative directors, and this be applied on an 'if not, why not' basis, as it is in the ASX Corporate Governance Council's Principles and Recommendations
- consistency be introduced to the definition of independence in the regulatory framework to reduce the regulatory burden.

Q3 What is an appropriate proportion of independent directors for superannuation boards?

Q4 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?

The ASX Corporate Governance Council's Principles and Recommendations recommend a majority of independent directors on the board, and that the chair be independent. Similarly, APRA applies to banking and insurance institutions not only the definition of independence found in the Principles and Recommendations but also the requirement for a majority of independent directors and an independent chair.

As stated in the influential Higgs Report[2] (that led to the revision to the UK corporate governance code and also influenced the first edition of the ASX Corporate Governance Council's guidelines):

> As the non-executive director does not report to the chief executive and is not involved in the day-to-day running of the business, they can bring fresh perspective and contribute more objectively in supporting, as well as constructively challenging and monitoring, the management team. … Although they need to establish close relationships with the executives and be well-informed, all non-executive directors need to be independent of mind and willing and able to challenge, question and speak up. … At least a proportion of non-executive directors also need to be independent in a stricter sense. There is natural potential for conflict between the interests of executive management and shareholders in the case of director remuneration, or audit (where decisions on the financial results can have a direct impact on remuneration), or indeed in a range of other instances. Although there is a legal duty on all directors to act in the best interests of the company, it has long been recognised that in itself this is insufficient to give full assurance that these potential conflicts will not impair objective board decision-making.

Less than a majority of independent directors on a board may be seen to be tokenism. Any fewer than a majority would not have the capacity to influence decisions taken by management, given that the central premises of independence are that all directors should take decisions objectively in the interests of the organisation, and that conflicts of interest do not provide assurance that such objective decision-making is undertaken.

Governance Institute recommends that a majority of independent directors is the appropriate proportion of independent directors for superannuation boards.

We note that the current two-thirds majority voting rule will need to be reviewed if a majority of directors are independent. No such majority voting rule applies to resolutions passed by company directors.

Independent chair
Separation of the role of chief executive and chair is seen as a central plank in a good governance framework, as it is avoids concentration of authority and power in one individual and differentiates leadership of the board from running of the business. To quote again from the Higgs Review, the following was the rationale for calling for the chairman of a public listed company to meet the independence test:

[2] Higgs, D, *Review of the role and effectiveness of non-executive directors*, January 2003

> The chairman needs to foster relationships of trust with both the executive and non-executive directors on the board, whilst at the same time maintaining support for, and partnership with, the chief executive. A degree of detachment from the executive can also be valuable in ensuring objective debate on strategy and other matters.

Governance Institute recommends that the chair of a board should be independent.

Consistency in governance framework

Given our earlier comments concerning the two primary models of superannuation funds, with the members of retail funds effectively being customers, it could be argued that there is less reason to call for a majority of independent directors to sit on the boards of trustees of commercial funds.

However, Governance Institute notes that the Financial Services Council (FSC) issued in March 2013 *FSC Standard No. 20 Superannuation Governance Policy*, which requires that the board of a member of FSC (retail funds) consist of a majority of independent directors and have an independent chair. The members of the FSC are bound to abide by its standards.

Given that retail funds have agreed to abide by a requirement to have a majority of independent directors and an independent chair, Governance Institute can see no reason why not-for-profit funds should not also be held to the same governance standards.

Board committees

Governance Institute is of the view that board committees should also reflect independence, given that committees exercise the delegated authority of the board to deal with specific matters. Generally speaking, only members of the board should sit on board committees. Good governance practice is that executive directors should be considered for membership of board committees only where the board considers it necessary to ensure that the requisite skills are represented. Executive director participation can usually be better achieved by inviting executive directors or non-director, external consultants to attend where they have important information or recommendations to provide to the committee. Where executive directors or external consultants sit on the committee, they should be in the minority. Importantly, in determining, and prior to finalising, the composition of committees, any conflict of interest (actual or perceived) that may arise should be considered.

Governance Institute therefore recommends that board committees of superannuation entities should mirror the requirements of the ASX Corporate Governance Council’s Principles and Recommendations, and:

- consist of a majority of independent directors — internal appointees (executive management) may sit on these committees but would not comprise the majority
- be chaired by an independent director, and
- comprise at least three members.

Recommendations

Governance Institute recommends that:

- a majority of the board should be independent directors
- the chair should be independent
- board committees should mirror the composition recommendations set out in the Principles and Recommendations — they should consist of a majority of independent directors, be chaired by an independent director and comprise at least three members. Internal appointees (executive management) may sit on these committees but would not comprise the majority.

Q5 Given the way that directors are currently appointed varies across funds, does it matter how independent directors are appointed?
Q6 Should the process adopted for appointing independent directors be aligned for all board appointments?

Determining the composition of a superannuation board is currently framed by the historical anachronism of having equal representation of employers and employees, the former often being represented by employer associations and the latter being primarily represented by unions. Equal representation was a means of ensuring that the employer, who had responsibility for the financial success of the fund, and employees, many of whom were in a union and whose financial interests were at stake, had oversight of and responsibility for the operations of the fund. Moreover, equal representation ensured an accountability mechanism was in place.

However, most funds are now accumulation funds, with the risk shifted to the employee, and employers are largely indifferent as to how best to facilitate the financial success of the fund. Moreover, most employees are no longer in unions. Neither group therefore best represents the interests of members of the fund.

Members of the Governance Institute are of the view that the key good governance outcome to aim for is to provide greater empowerment to members and greater accountability of directors to members rather than to other parties, such as employers, unions or a corporate group. Within this context, the manner in which directors are appointed is a key governance issue, as is the need for consistency across the superannuation industry.

Providing for accountability to members
Governance Institute is *not* of the view that a solution lies in introducing annual general meetings (AGMs) to provide for greater empowerment to members and greater accountability of directors to members. We note that the Cooper Review canvassed the difficulties of this — the *Super System Review: Final Report* states that:

> In its first Issues Paper on Governance, the Panel canvassed the idea of trustees holding an annual general meeting (AGM) for members of large APRA funds so that members would have a forum to exercise powers in the same way that shareholders can exercise powers with respect to directors at an AGM. While the Panel was initially somewhat attracted to this concept, it has been convinced by the overwhelming weight of submissions that the structural and logistical issues inherent in the superannuation industry make it impractical and undesirable at this time to require superannuation funds to hold AGMs.

Governance Institute is on the record, and has been noting for a number of years, that the AGM requires significant reform. In its current form, the AGM as an event is primarily concerned with the engagement of retail shareholders (it does not attract institutional investors), and it fails in this regard. The AGM does not provide a voice for members of corporations in its current form — Australia is the world's sixth largest country (7,682,300 sq km) and shareholders are dispersed geographically. Physical attendances at AGMs, which has been declining over many years, will never approach a meaningful percentage of the number of holders a company has, and nor in the case of large companies (some of which now have well over 1,000,000 shareholders) would that be desirable. Given the large membership base of many superannuation funds, similar issues would arise in seeking to engage members through the forum of an AGM.

Our research has shown that shareholders are often more comfortable asking questions of the directors and senior management after the formal AGM than during the meeting. They engage more easily with directors and senior management at non-statutory investor briefings than at the

AGM. Anecdotal evidence from companies' experience shows that retail shareholders are more engaged (and more likely to attend) an informal shareholder meeting where they can just hear from the board and executives and ask questions about a company's present condition and performance, rather than sit through a lengthy and highly formal meeting structured around the resolutions that need to be passed.

We are of the view that these findings are useful to consider when assessing how best to provide for superannuation fund member engagement.

Governance Institute recommends that superannuation funds provide for member engagement as best suits the members, but that the form of engagement not be legislated. It could differ from fund to fund. Moreover, technology will continue to evolve and superannuation funds will innovate as to how best to provide for member engagement. We do not support an AGM or other statutory meeting as a means of providing for accountability to members.

Member right to appoint directors

However, the question of how to provide members with a voice in appointing — and, if necessary, removing — directors remains. All funds are owned by individual members. It is a matter of good governance that those members should have a say in who represents them to act in their best interests.

In our review of the AGM, we have canvassed various reforms.[3] Our current recommendation, given that the AGM as an event in its current form does not function well as a decision-making forum, is that consideration be given to removing the decision-making function of the AGM. A public listed company would still have a statutory obligation to hold a meeting of shareholders at least once every calendar year, but no decision-making business would be carried out at that meeting. A public listed company would also be required to put resolutions to the votes of members, but this would occur through online, direct voting at a time separate from the AGM.

Governance Institute strongly recommends that members of superannuation entities should be provided with the right to appoint directors, but that the decision-making (voting) should not be connected to a statutory meeting.

Process for voting

Members could appoint directors and influence board composition via direct voting and on a poll, with a default of online voting.[4]

Direct voting enables members to exercise their voting rights:

- without the need to attend meetings
- and improves the exercise of voting rights because it removes the intermediary between the member and the entity — members are not required to transfer their right to vote to another party as currently happens with the appointment of a proxy.

Currently superannuation funds provide members with quarterly or six-month statements. The annual report is made available to members on the website of the fund. When one of the statements is provided to members (funds could nominate which statement would be linked), a voting form with the biographies of nominated directors and explanations as to why they are

---

[3] Chartered Secretaries Australia, *Rethinking the AGM: discussion paper*, May 2008; Submission to CAMAC, *The AGM and shareholder engagement*, December 2012, available at governanceinstitute.com.au/media/455201/final_submission_future_agm_shareholder_engagement.pdf. Governance Institute of Australia was formerly known as Chartered Secretaries Australia

[4] Chartered Secretaries Australia (CSA), *Expressing the voice of shareholders: a move to direct voting: discussion paper*, March 2006, available at http://www.governanceinstitute.com.au/media/35406/direct_voting_web.pdf; and *CSA's guide to implementing direct voting*, 2007, available at http://www.governanceinstitute.com.au/media/37721/Guide_implementing_direct_voting.pdf

considered independent or not would also be sent to members. The voting form would be provided in both hard copy and online. There would be a requirement for superannuation funds to keep the polls open for a set period of time (for example, 28 days) and the poll results would be announced as soon as practicable after the polls close (to allow for a proper review to ensure validity of voting). Voting results would be open to public scrutiny.

However, unlike shareholders in companies, voting would not be conducted on a 'one member, one vote' basis, but on the basis of the dollar value per vote, in similar fashion to managed investment schemes (MISs). Indeed, given that the regulatory framework is already in place for MISs, and given that there is not a great deal of difference between superannuation funds and other funds management businesses (the difference being that in superannuation members cannot access their funds until retirement), it creates efficiency to apply an existing regulatory framework to the superannuation industry.

A focus on voting will encourage greater engagement on the part of members. While Governance Institute recognises that there is considerable apathy on the part of members in relation to engagement with their funds at present, we are of the view that the current apathy:

- will not be permanent — as members are empowered through the capacity to influence board composition they will seek further engagement, and as financial literacy projects in Australia are furthered, member interest in superannuation is likely to increase
- is not sufficient reason to refuse members the right to elect directors to act in their best interests.

It is not good governance to allow employers, unions or employer organisations, that is, those with conflicts of interests, to have control of the voting process (except to set up the necessary administrative and procedural aspects).

Therefore, employers, unions and employer organisations should not:

- vote
- control or manipulate the voting process
- set the rules without approval by members.

The rules concerning voting should be set out in the constitution of the superannuation fund and made available to members in an easily accessible corporate governance section of the website. Constitutional amendment should be subject to member approval.

Recommendations
Governance Institute recommends that:

- members of superannuation entities should be provided with the right to elect directors via direct voting, but that the decision-making (voting) should not be connected to a statutory meeting
- employers, unions and employer organisations should not vote, control the voting process or set the rules for voting without approval by members
- the rules concerning voting should be set out in the constitution of the superannuation fund and made available to members in an easily accessible corporate governance section of the website
- constitutional amendment should be subject to member approval.

Q7 Are there any other measures that would strengthen the conflict of interest regime?

Superannuation entity boards are typically comprised of an equal number of directors appointed by either an employee body (a union) or employer body or, in the case of public-sector funds, a state or federal government. A conflict of interest or duty or perceived conflict of interest or duty may arise where a director is appointed to the board by such a sponsoring body. For example, a director may have in mind that they have been appointed to a superannuation entity to represent the interests of a particular union or industry body — they may be of the view that their appointment has been made in order to ensure they can control or influence, as well as monitor, the activities of the superannuation entity to which they have been appointed. Alternatively a director appointed to the board by a sponsoring body could be perceived to have been appointed in order to control and influence, even when the director is clear that they have been appointed to represent the best interests of the beneficiaries rather than those of the sponsoring body.

That is, more often than not, conflicts of interest in the superannuation system arise by reason of the appointed person representing an appointing body whose interests could differ from those of the trustee, rather than by reason of personal, material conflicts. A recent example is bank-managed public offer fund investing all cash in the bank rather than elsewhere which may provide better interest rates.

Directors appointed by sponsoring bodies have the same legal and regulatory obligations as other directors or trustees, for example, they must satisfy the fit and proper test, and exercise their powers in the best interests of the beneficiaries of the superannuation entity. Directors appointed by sponsoring bodies, therefore, need to be more than usually alive to the possibility of a conflict between the interests or duties owed to the beneficiaries and not only their own personal interests but also the interests of their appointer. To the extent of conflict, in exercising their powers as a director they must prefer the interests of the beneficiaries.

Resulting from the Cooper Review's report on such matters, APRA now requires that a superannuation entity have in place a conflicts of interest policy. However, the prudential standard does not address related parties.

Related party dealings
It is good governance for any conflicts of interest policy to convey the message to all responsible persons in the superannuation entity that integrity and effective control cannot be compromised in any business dealing when any party is a related party. Related parties, under superannuation law, include members or associates of the superannuation entity, or a standard employer-sponsor, or an associate of a standard employer-sponsor of the superannuation entity. More broadly, it is good practice for a superannuation entity to recognise that there might be other types of related parties with whom conflict may arise, including:

- controlling entities of the superannuation fund, and
- families and relatives of directors or trustees of the superannuation fund, including children, spouses and parents.

Governance Institute recommends that the policy on conflicts of interest should address how the entity will manage related party transactions.

Disclosure of relevant interests or relevant duties
While a director of a corporate trustee is required under the Corporations Act to make various disclosures about their material or personal interests in matters that relate to the company, superannuation law does not require a responsible person to make such disclosures.

Upon being appointed as a director of a trustee, it is good practice for a director to disclose their material or personal interests in a 'standing notice'. The entity should set out the guiding principles for the disclosure of those interests.

The standing notice should provide details of:

- the nature and extent of the interest, including any significant relationships which may create conflicts of interest/loyalty, and
- how the interest relates to the affairs of the superannuation entity.

Directors should give and update notices of their material or personal interests.

The directors of a superannuation fund, at the commencement of a board meeting, ought to be asked to declare any change in the nature and extent of the interest in relation to any of the items on the meeting agenda. If they do, the meeting should then determine the extent to which they may or may not participate in the discussion and vote on that matter. Any declared conflicts of interest and board decisions relating to these should be minuted.

Superannuation entities should ensure that the recording of declared conflicts is consistent with their conflicts of interest policy.

We recognise that many superannuation entities already have implemented such sound governance practices, but are of the view that they should be mandatory.

Governance Institute recommends that directors of superannuation entities be required to:

- disclose their material or personal interests in a 'standing notice' upon being appointed as a director of a trustee
- provide update notices of their material or personal interests
- provide for the minutes to show any declared conflicts of interest and board decisions relating to these.

Voting at board meetings

It is good governance for superannuation entities to set out their process for managing conflicts of interests when directors of the superannuation entity are voting on decisions at board meetings where such conflicts arise.

Directors of corporate trustees will have duties under the Corporations Act that prohibit them from being present or voting in such circumstances. However, directors of other superannuation entities are not subject to such prohibitions.

Governance Institute recommends that directors of superannuation entities who have a material or personal interest in a matter being considered at a directors' meeting should:

- not be present while the matter is being considered at the meeting and
- not vote on the matter.

Governance Institute also recommends that a director of a superannuation entity may be present and vote if the directors who do not have such an interest pass a resolution identifying the director; the nature and extent of the director's interest and its relation to the affairs of the superannuation entity; and stating that the directors without a material personal interest are satisfied that the interest does not disqualify the director with the interest from being present at the meeting or voting on the matter. This might occur if the directors had formed a view that allowing the director to be present and vote was in the best interests of the superannuation entity and its beneficiaries. By way of example only, this might occur in circumstances where it is necessary to maintain a quorum, however the 'conflicted director' would be asked to abstain from voting.

Remuneration

Legislation was passed in 2012 that mandates the disclosure of remuneration details of each director or other executive officer if the Registrable Superannuation Entities (RSE) licensee is a body corporate, or each trustee if the RSE licensee is a group of individual trustees from 1 July 2013.[5] Trustees need to disclose all payments, benefits and compensation paid for or provided by the trustee or by related bodies corporate.

---

[5] S 29QB of the SIS Act requires RSE licensees to disclose on their website the remuneration details of each 'executive officer' (if the RSE licensee of the registrable superannuation entity is a body corporate) or

ASIC originally exempted superannuation entities from the disclosure until 31 October 2013. On 15 October 2013, ASIC registered Class Order [CO 13/1275] to exempt APRA RSE licensees from the new trustee remuneration disclosure obligations until 1 July 2014. The class order amends Class Order [CO 13/830] which had previously deferred the original start date from 1 July 2013 to 31 October 2013. In deferring the start date again to 1 July 2014, ASIC noted that it had become clear that the superannuation industry needed further time to consider the inherent complexity of the reforms. This is not surprising — listed entities have had years to adjust to ever-increasing remuneration disclosure requirements, with the first requirements for executive remuneration disclosure effective in 1987. It was not to be expected that superannuation entities could adjust to similar disclosure requirements in one year.

Disclosure is an important aspect of accountability. However, it is equally important to ensure that no conflicts of interest arise in the setting of remuneration for management. A core governance concept is that no individual should be directly involved in deciding their own remuneration.

Our earlier recommendation that board committee requirements for superannuation entities mirror those for listed companies in the Principles and Recommendations would ensure that the remuneration committee be comprised of a majority of independent directors, and that management would not therefore be deciding their own remuneration.

Q8 In relation to board renewal, should there be maximum appointment terms for directors? If so, what length of term is appropriate?
Q9 Should directors on boards be subject to regular appraisals of their performance?

A high performing, effective board is essential for the proper governance of any organisation. Board renewal is critical to performance. To promote member confidence, there should be a formal, rigorous and transparent process for the appointment and reappointment of directors to the board. As recommended earlier, members should have the right to appoint or reappoint directors to the board.

Board evaluation is a key element in corporate governance and linked strongly to board renewal. It is seen as an essential tool in achieving better board performance and effectiveness. Boards examine the way in which they discharge their duties and their overall performance to achieve continuous improvement. A formal and rigorous external assessment of board performance at least every two or three years and an annual internal assessment is now a recognised method to achieve this aim.

Director elections and tenure

Director elections and tenure

Governance Institute is a strong supporter of directors of public listed companies being required to stand for re-election every three years. As not all directors are appointed to the board simultaneously, in practice this means that the entire board does not stand for re-election every third year. In turn, this means that board renewal and succession planning can be managed in the best interests of the entity.

We note that providing for director re-election every third year appears as if it could overcome the current situation where some trustee-directors seem to be appointed for an unlimited term or

---

each trustee (if the RSE licensee is a group of individual trustees). The SIS Regulations also set out details of information that RSE licensees must make publicly available (and keep up-to-date at all times) on the RSE's website, including details of trustee remuneration (SIS reg 2.37) and information relating to the fund (for example, trust deed, PDSs, trustee details, significant event notices etc): SIS reg 2.38. The provisions do not apply to SMSFs.

where turnover on the board rarely happens, or only happens for some trustee-directors and not others.

The ASX Corporate Governance Council undertook a public consultation in the latter half of 2013 on the proposed 3rd edition of the Principles and Recommendations. One of the proposed amendments related to the introduction of tenure as an indicator of independence. The proposed amendment suggested that after nine years a director may no longer be considered independent. Many submissions argued against this, including ours.

Our view is that open-mindedness to new ideas is a central tenet of independence of judgment, rather than any indicator, including tenure, applied in isolation. Prescribing a limit on tenure assumes that the longer a director is on the board, the less independence they have in undertaking their role. However, this assumption fails to account for the fact that board members should be undertaking ongoing education and training to ensure that their skills remain up-to-date — their skills and knowledge of an organisation improve the longer they are on the board.

Importantly, our view is that board composition policy should look to have a mix of directors on the board with different skills and a robust board renewal plan should be in place.

We note that some other jurisdictions, including the United Kingdom (UK) currently include tenure as a criterion for independence in their governance codes. There has been considerable reflection on the focus on and causes of short-termism in the United Kingdom, and there has been discussion of how best to provide for long-term decision-making on boards, including providing for corporate memory and deep industry experience.

Governance Institute is of the view that a requirement that directors stand for re-election every three years in superannuation entities may pose a risk to board renewal. Unions and employer representative associations may find it easy to garner sufficient member support for the re-election of a particular director on multiple occasions. While Governance Institute of Australia is of the view that the preferred model in relation to tenure is that there is no firm threshold for when the length of a directorship affects independence, we are of the view that in the context of superannuation entities, setting tenure through APRA Prudential Regulation standards may be the only means possible of securing board renewal. Given the historical context of the superannuation system, director tenure may be required in the early stages of reinvigorating the governance framework, but any limit should be subject to review after some years. As a new governance framework is embedded and understood, the question of whether a limit on tenure remains the appropriate approach should be revisited.

Recommendation
Governance Institute recommends that a limit on the tenure of director appointments should be implemented and be subject to members having the right to appoint and re-elect directors of superannuation entities. Such a limit should be subject to review after some years.

Board evaluation
Governance Institute Members are strong supporters of board evaluations. In November 2013, we issued a new edition of our publication, *Enhancing Board Effectiveness*, which contains a chapter on board evaluation. The following quote setting out the benefits of a board evaluation is from that publication:

> In summary, a formal board review is a good opportunity for:
> - assessing the extent to which the board believes it is meeting its responsibilities as set out in the board and committee charters
> - clarifying individual and collective roles in the governance system
> - improving the effectiveness of board meetings

- improving the relationships between the board and management
- clarifying areas for improvement in internal and external reporting relationships, including information that comes to the board
- areas of development for board members
- a healthy review of board composition
- team building among directors.

It should be the board that decides the best way to conduct a review. What works for one organisation may not work for another. We are therefore of the view that a board evaluation should not be prescribed, but that the board should be required to disclose to members whether a board evaluation has taken place in the previous 12 months and the process undertaken for such a review.

We are of the view that:

- a board should set a time for the annual review of its performance as part of its annual calendar of commitments
- the board should establish the terms of the review, key performance indicators and expected outcomes
- the board should determine the best way to conduct a review — while boards are encouraged to undertake a formal and rigorous external assessment of board performance at least every two or three years and an annual internal assessment, the process chosen remains a matter for the board to determine
- the review should include review of the chair, individual directors and board committees.

Governance Institute recommends that the board should be required to report to members on the process for evaluating the performance of the board, its committees and directors, but should not be required to disclose outcomes.

Q10 Would legislation, an APRA prudential standard, industry self-regulation or a combination be most suitable for implementing changes to governance? What would the regulatory cost and compliance impacts of each option be?

Q11 What is the appropriate timeframe to implement the Government's governance policy under each option?

Q12 Given that there will be existing directors appointed under a variety of terms and conditions, what type of transitional rules are required?

Our preference is for a principles-based approach to governance. The Principles and Recommendations have played a vital role in improving corporate governance in Australian listed companies since the release of the first edition in 2003. Their history is one of practical statements on governance which have brought meaningful change to governance practice and behaviour.

Legislation

Governance Institute does not support legislating governance standards. The success of the Council's Principles and Recommendations in in lifting and maintaining Australia's standing as a country with a high-performing corporate governance environment lies in their acceptance that there is no 'one-size-fits-all' governance framework. Different entities may legitimately adopt different governance practices, based on a range of factors, including their size, complexity, history and corporate culture. For that reason, the Principles and Recommendations are not mandatory and do not seek to prescribe the corporate governance practices that a listed entity must adopt. The choice of such practices is fundamentally a matter for the entity's board of directors, the body charged with the legal responsibility for managing its business with due care and diligence. It is a listed entity's board of directors who are responsible for ensuring that it has appropriate corporate governance practices in place and who should be prepared to explain and justify those practices to shareholders and the broader investment community — the 'if not, why not' approach.

Importantly, members of superannuation entities should be provided with the right to appoint directors, as they can express their views as to the governance of the fund through this mechanism.

We also note that corporate governance in the United States — which has taken a black-letter law approach to corporate governance — is seen to lag behind that of Australia and other jurisdictions that have taken a principles-based approach.

Notwithstanding our preference for a principles-based approach to governance, we are of the view that some legislative amendments are required, given the historical regulatory framework relating to superannuation entities.

Governance Institute recommends that the only legislative amendments that should be undertaken are to:

- revise the existing equal representation legislative provisions
- address issues relating to the definition of independence in the SIS Act
- provide for a member right to elect directors of trustees via direct voting.

APRA prudential standards

Governance Institute has already expressed concern as to the prescriptive nature of APRA's prudential standards for banks and insurance organisations on many governance matters that should be left to the determination of the board. For example, we do not support APRA applying the indicators of independence set out in the Council's Principles and Recommendations in a prescriptive fashion.

We are of the view the view that APRA prudential regulation standards neither provide greater flexibility than legislation nor are less prescriptive than legislation.

We also do not believe that making disclosures on governance to APRA alone will empower members.

Notwithstanding this, there are certain aspects of practice that may be best dealt with in the APRA prudential standards.

Governance Institute recommends that APRA prudential standards be revised to require superannuation entities to:

- provide a governance statement to members in their annual report disclosing on an 'if not, why not' basis how the board has responded to a series of recommendations on governance practice, including:
    - independence of the board
    - independence of the chair
    - independence of board committees
    - whether a board evaluation evaluation took place and the process of such an evaluation, and

  these disclosures should be made on the public access sections of the website of the superannuation entity, so that any individual can assess the governance of the fund as part of their decision as to whether to become a member of that fund
- address how the entity will manage related party transactions in its conflicts of interest policy

- disclose their material or personal interests in a 'standing notice' upon appointment as a director, providing details of the nature and extent of the interest; and how the interest relates to the affairs of the superannuation entity
- not be present while any matter in which they have a material or personal interest is being considered at a directors' meeting and not vote on any such matter being considered at a directors' meeting.

Self-regulation

'Sunlight is said to be the best of disinfectants; electric light the most efficient policeman,' said Justice Louis Brandeis, US Supreme Court of Justice, in 1933. It was made in the context of President Roosevelt's New Deal reform programs that eventually led to the passing of the Securities Act of 1933, the Securities Exchange Act of 1934, and the creation of the US Securities and Exchange Commission (SEC). Disclosure is concerned with transparency, that is, letting the truth be available to all and was introduced to ensure that investors were informed when they took their decisions. Disclosure is seen as an effective tool for improving investor protection.

As noted earlier, each ASX listed company is required under Listing Rule 4.10.3 to include in its annual report a corporate governance statement that meets the requirements of that rule, which is how disclosure against the Principles and Recommendations is given effect.

Director elections by shareholders are connected to members having access to disclosure of governance frameworks within listed entities. If shareholders are unhappy with the explanations provided, they can choose to not re-elect directors.

It is our view that any disclosures on governance introduced for superannuation entities need to be linked to the right of members to elect directors.

Without a disclosure obligation, self-regulation for the superannuation industry is unlikely to provide the transparency and accountability to members that a good governance framework requires. We are of the view that an 'if not, why not' disclosure obligation should be introduced for superannuation entities in relation to the majority of the governance issues dealt with in the discussion paper and our submission. Our view is that more and more members of superannuation funds will take a keen interest in the governance of their funds and will wish to assess disclosures from their funds on governance matters. This in turn will inform their voting decisions on director appointments.

As noted earlier, while Governance Institute Members recognise that there is considerable apathy on the part of members in relation to engagement with their funds at present, we are of the view that the current apathy will not be permanent — as members are empowered through the capacity to influence board composition they will seek further engagement. Making disclosures to APRA alone will not empower members.

The APRA prudential standards could require superannuation funds to make disclosures on governance matters to their members. We strongly recommend that this be on an 'if not, why not' basis. APRA, as the regulator, would have the power to compel any superannuation entity that did not make such disclosures to make such disclosures. However, it would not be APRA alone that judged the quality of the disclosures, as is currently the case, but also the members.

Recommendation

Governance Institute recommends that:

- the APRA prudential standards be revised to mandate disclosure by superannuation entities to their members, on an 'if not, why not' basis, of how the board has responded to a series of recommendations on governance practices, including independence of the board, the chair, committee composition and board evaluation, and

- these disclosures should be made on the public access sections of the website of the superannuation entity, so that any individual can assess the governance of the fund as part of their decision as to whether to become a member of that fund.

Timeframe for implementation
Listed entities have been required to make governance disclosures for ten years, since the introduction of the Council's Principles and Recommendations in 2003.

Bringing disclosure on governance for superannuation entities into line with that of listed entities is likely to be an extremely complicated process for most superannuation funds, many of which have not disclosed much of this information or considered how to effect the changes to their governance frameworks that such disclosures would entail. It would be unfair to ask superannuation entities to manage such a transition in just one year, particularly given that they are still coming to grips with the reforms introduced under MySuper, including the disclosure of investments requirement (itself likely to be subject to further change, as it is considered in a later section of the discussion paper). System changes and testing will need to be undertaken and embedded, and there is insufficient time for such activities to be finalised before 1 July 2014. The earliest that any such changes should apply should be 1 July 2015.

We note that when a new edition of the ASX Corporate Governance Council's Principles and Recommendations are released, the change in the reporting requirement applies to the company's first financial year commencing after the release of the new edition, but that companies are encouraged to adopt the new reporting requirements earlier, if they wish.

Governance Institute recommends that the earliest that any changes should take effect should be 1 July 2015, with the new requirements applying to the first financial year after that date.

Transition rules
Governance Institute notes that when corporations law amendments are introduced, the Australian Securities and Investments Commission (ASIC) undertakes an education awareness program in the early stages of the implementation of the new regulatory regime to assist companies to understand and effect their new obligations. ASIC may issue warning notices to companies as part of this awareness campaign.

Governance Institute recommends that APRA undertake an education awareness campaign designed to assist superannuation entities to understand and effect their new obligations in the early stages of the implementation of the new regulatory regime, and issue warning notices as appropriate to superannuation entities.

PART 3: ENHANCED TRANSPARENCY

Questions 13—19

Governance Institute has no comment on the section dealing with the product dashboard.

Q20 Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs? In considering this question, you may wish to consider the various options discussed above:

- **Should portfolio holdings disclosure be consistent with the current legislative requirements (that is, full look through to the final asset, including investments held by collective investment vehicles)?**
- **Should the managers/responsible entities of collective investment vehicles be required to disclose their assets separately? To give effect to this requirement, legislation would require all collective investment vehicles to disclose their asset holdings, regardless of whether some of its units are held by a superannuation fund.**
- **Should portfolio holdings disclosure be limited to the information required to be provided to APRA under Reporting Standard SRS 532.0 Investment Exposure Concentrations?**

Q21 What would be the compliance costs associated with each of these models for portfolio holdings disclosure?

Q22 Should portfolio holdings information be presented on an entity level or at a product (investment option) level?

Q23 Is a materiality threshold an appropriate feature of portfolio holdings disclosure?

Q24 What is the impact of a materiality threshold on systemic transparency in superannuation fund asset allocation?

Q25 What would be the most appropriate way to implement a materiality threshold?

While Governance Institute members are strong supporters of disclosure, we believe that disclosure should be meaningful. Too much disclosure can be as obfuscatory as a complete lack of transparency.

We are of the view that the requirement to disclose all portfolio holdings does not lead to meaningful disclosure. With funds held indirectly through custodians and nominees, and with thousands of investments, the disclosure requirement is based on quantity rather than quality.

We also note that the original aim of disclosure was to make the truth available to all. This is the basis of Australia's continuous disclosure regime — all investors should have equal access to the same information that could have a material impact on the share price.[6] We therefore do not support a disclosure requirement that requires the technical knowledge of a financial adviser to analyse the disclosures.

We refer to earlier comments that there should be as much consistency in the regulatory framework as possible, to ensure a reduction in the compliance burden, and enhanced understanding of any compliance obligations.

ASX has given particular attention to questions of materiality in relation to aspects of continuous disclosure obligations, in particular where an entity becomes aware that its reported earnings will differ materially from market expectations. Given the many variables involved in determining whether any variation may constitute market-sensitive information, ASX has deliberately refrained from providing any general quantitative materiality thresholds. However, where an entity has published specific earnings guidance and it expects its earnings to differ from that

---

[6] Under both ASX Listing Rule 3.1 and the Corporations Act 2001 (Cth), the core obligation of a listed entity under the continuous disclosure regime is to immediately disclose any information that concerns it to the ASX, if a reasonable person would expect that information to have a material effect on the price or value of the entity's securities (market-sensitive information). There are very limited exceptions to this rule, which are contained in Listing Rule 3.1A.

guidance, failing to disclose that information may constitute misleading conduct under the Corporations Act, and accordingly ASX has prescribed that a variation of:

- 10 per cent or more should be presumed to be material and therefore should be disclosed
- 5 per cent or less should be presumed not to be material and therefore need not be disclosed, and
- between 5 and 10 percent will require the entity to form a judgment as to whether or not it is material.

Governance Institute recommends that:

- a materiality threshold be introduced for portfolio holdings disclosure, which would relate to the total fund and would be based on:
  - 10 per cent or more should be presumed to be material and therefore should be disclosed
  - 5 per cent or less should be presumed not to be material and therefore need not be disclosed, and
  - between 5 and 10 percent will require the entity to form a judgment as to whether or not it is material.

Large superannuation funds will have holdings through a number of fund managers and will need to aggregate.

Q26 Should the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

Any commencement date for portfolio holdings disclosure should be aligned with the introduction of other aspects of changes to the regulatory regime. Moreover, we note that, given the consultation paper is canvassing views on the appropriate model of portfolio holdings disclosure, it would be inappropriate to implement the disclosure obligation mid-2014 when its features are still under active discussion.

Governance Institute recommends that the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014 and be introduced no sooner than 1 July 2015.

PART 4: ENHANCING COMPETITION IN THE DEFAULT SUPERANNUATION MARKET

Governance Institute has no comment on the section dealing with enhancing competition in the superannuation market.

Governance Institute of Australia recommendations

Governance Institute recommends (noting that these recommendations apply to defined contribution schemes and not to defined benefit schemes):

Question 1

- using existing principles-based approaches to governance in place for listed entities and modifying them for application to superannuation entities as required rather than developing a new regulatory framework relating to the governance of superannuation entities

Question 2

- that the ASX Corporate Governance Council’s approach to independence be adopted and applied to superannuation entities, and extended to include consideration of where a person is is, or has been in the last three years:
    - an employee or executive of an employer of members of the fund, or
    - an employee or official of a trade union, or other organisation, representing the interests of members of the fund
    - an employee of an employer association or body, representing the interests of the employer

- that this be applied on an 'if not, why not' basis, as it is in the ASX Corporate Governance Council's Principles and Recommendations

- that consistency be introduced to the definition of independence in the regulatory framework

Questions 3 and 4

- that a majority of the board should be independent directors

- that the chair should be independent

- that board committees should mirror the composition recommendations set out in the Principles and Recommendations — they should consist of a majority of independent directors, be chaired by an independent director and comprise at least three members. Internal appointees (executive management) and external consultants may sit on these committees but would not comprise the majority

Questions 5 and 6

- that superannuation funds provide for member engagement as best suits the members, but that the form of engagement not be legislated

- that members of superannuation entities should be provided with the right to elect and remove directors via direct voting, but that the decision-making (voting) should not be connected to a statutory meeting

- that employers, unions and employer organisations should not vote, control the voting process or set the rules for voting

- that the rules concerning voting should be set out in the constitution of the superannuation fund and made available to members in an easily accessible corporate governance section of the website, and

- that constitutional amendment should be subject to member approval

Question 7

- that directors of superannuation entities be required to:
    - disclose their material or personal interests in a ‘standing notice’ upon being appointed as a director of a trustee, including any significant relationships which may create conflicts of interest/loyalty
    - provide update notices of their material or personal interests
    - provide for the minutes to show any declared conflicts of interest and board decisions relating to these

- that directors of superannuation entities who have a material or personal interest in a matter being considered at a directors’ meeting should:
    - not be present while the matter is being considered at the meeting and
    - not vote on the matter

Questions 8 and 9

- that a limit on the tenure of director appointments should be implemented and be subject to members having the right to appoint and re-elect directors of superannuation entities — such a limit should be subject to review after some years

- that the board should be required to report to members on the process for evaluating the performance of the board, its committees and directors, but should not be required to disclose outcomes

Questions 10, 11 and 12 (process of dealing with change)

- that the only legislative amendments that should be undertaken are to:
    - revise the existing equal representation legislative provisions
    - address issues relating to the definition of independence in the SIS Act
    - provide for a member right to elect directors of trustees via direct voting

- that APRA prudential standards be revised to require superannuation entities to:
    - provide a governance statement to members in their annual report disclosing on an 'if not, why not' basis how the board has responded to a series of recommendations on governance practice, including:
        - independence of the board
        - independence of the chair
        - independence of board committees
        - whether a board evaluation evaluation took place and the process of such an evaluation, and

  these disclosures should be made on the public access sections of the website of the superannuation entity, so that any individual can assess the governance of the fund as part of their decision as to whether to become a member of that fund

    - address how the entity will manage related party transactions in its conflicts of interest policy
    - disclose their material or personal interests in a ‘standing notice’ upon appointment as a director, providing details of the nature and extent of the interest; and how the interest relates to the affairs of the superannuation entity
    - not be present while any matter in which they have a material or personal interest is being considered at a directors’ meeting and not vote on any such matter being considered at a directors’ meeting
    - impose a limit on tenure for director appointments

- that the earliest that any changes should take effect should be 1 July 2015, with the new requirements applying to the first financial year after that date

- that APRA undertake an education awareness campaign designed to assist superannuation entities to understand and effect their new obligations in the early stages of the implementation of the new regulatory regime, and issue warning notices as appropriate to superannuation entities

Questions 20—25

- that a materiality threshold be introduced for portfolio holdings disclosure, which would relate to the total fund and would be based on:
    - 10 per cent or more should be presumed to be material and therefore should be disclosed
    - 5 per cent or less should be presumed not to be material and therefore need not be disclosed, and
    - between 5 and 10 percent will require the entity to form a judgment as to whether or not it is material

Question 26

- that the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014 and be introduced no sooner than 1 July 2015.