Superannuation Fund Governance

ASFA Discussion Paper

September 2013

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1 Introduction

Good governance of superannuation funds is essential in order to ensure the performance of the trustee board in carrying out its trust and fiduciary duties owed to members and beneficiaries is both optimised and transparent. Good governance provides a framework of accountability for trustee boards and empowers them to establish appropriate policies, procedures and controls commensurate with the risks associated with the operation of their fund.

In a compulsory and concessionally taxed system, it is critical that those entrusted with looking after the retirement incomes of ordinary Australians are required to achieve and maintain high levels of effective governance. This is particularly important given that the size of Australia's superannuation pool continues to grow and the increasingly important role that trustee boards play in delivering comfortable retirement incomes and in investing in the economy in an efficient and cost-effective manner.

1.1 Purpose of this discussion paper

The purpose of this paper is to engage the industry in a discussion on sound practice in the area of superannuation fund governance and gather views from ASFA's membership on various governance related issues including:

- Independence
- Role of the Chair
- Trustee board structure
- Gender diversity
- Performance and competency
- Remuneration
- Tenure
- Conflicts of interest and duty
- ESG factors
- Proxy voting

ASFA does not set standards or have enforcement powers and, as such, the purpose of this paper is not to impose a set of principles that must be adopted. Rather, the intent of this paper is to stimulate debate and, to the extent that it is possible, assist the industry in developing consensus on the governance related areas listed above. Where consensus is not possible, your feedback will assist to highlight the different governance structures and/or approaches applicable to the superannuation sector.

1.2 Structure of the discussion paper

Wherever possible, we have outlined various options available with respect to the particular governance issue discussed and the merits and drawbacks of these different options. However, there may be other governance processes which have not been addressed in this paper or have only partially been covered but would benefit from greater clarification or expansion – your feedback in this regard will be very helpful to ASFA.

We have endeavoured to provide as much background as possible on the current state of affairs on a particular issue (i.e. under the legislation and/or prudential framework) whilst recognising the need to keep the discussion paper to a reasonable length.

In some areas we have expressed a preliminary view on the option ASFA believes may provide an optimal outcome in terms of ensuring that a fund's business operations are managed soundly and prudently by a competent trustee board, which has the capacity to make reasonable and impartial decisions in the best interests of fund members and beneficiaries. Some of these preliminary views may be controversial or go beyond what is currently required by the law or the regulators.

Where we have raised a potential issue, the resolution of which would require legislative or regulatory change, an affirmative response from you to the corresponding consultation question will be taken to mean that you support the relevant proposition and effectively 'endorse' ASFA to lobby for legislative and/or regulatory change on that issue at the appropriate juncture.

Where we have expressed a preliminary view, we have attempted to support this with reasoned arguments both for and against. However, regardless of whether or not we have expressed a preliminary view on a particular area, ASFA has not come to a final position on the issues in question. In all cases we are looking for your feedback, whether or not your position supports this preliminary view. To facilitate this we have included a number of discussion questions around each of the governance areas covered in this paper. These consultation questions are embedded throughout the relevant sections of this document (section 3 – 12) as well as being summarised in a single table within the Appendix.

2 Feedback from ASFA members

We would appreciate your feedback on any and all of the discussion questions or, indeed, any other comments you might have with regard to superannuation fund governance.

The feedback gathered from our members will be used by ASFA to develop policy positions aimed at improving fund governance and ensuring that a fund's business operations are managed soundly and prudently by a competent trustee board.

In particular, the feedback we receive from our members and resulting policy positions will be used as the basis for updating *ASFA Best Practice Paper No. 7 – Superannuation Fund Governance* (BPP No. 7), which is in the process of being amended to take into account the new APRA prudential standards for superannuation and the accompanying prudential practice guides (PPGs). Once updated, it is envisaged that BPP No. 7 will be relaunched in 2014.

As with all our best practice papers, BPP No. 7 is not intended to convey or mandate the only way to address an issue. Rather, ASFA's best practice series is intended to provide superannuation trustees and their service providers with information about sound superannuation practice in Australia at the time of publication of the paper.

Your feedback

Please send your written comments to:

Jon Echevarria
Senior Policy Adviser
The Association of Superannuation Funds of Australia Limited (ASFA)
Email: jechevarria@superannuation.asn.au

This consultation process will end on **Friday, 18 October 2013**.

The feedback we receive on this discussion paper will be used by ASFA for the purpose of developing its policy position and the best practice paper only and any commercially confidential or sensitive information will not be shared with other organisations.

More detailed information around each of the governance-related issues is contained in Sections 3 – 12. A summary table containing all the consultation questions raised on each of the areas is shown in the Appendix to this discussion paper.

In providing ASFA with your feedback, we would appreciate as much evidence-based information as possible – any statistical data to support your comments would be particularly useful in terms of future advocacy and guidance ASFA may undertake with respect to governance issues.

3 Independence

3.1 Requirement to have independent board members

There are strong (diverging) views in relation to the merits or otherwise of having independent members on trustee boards. Some would argue that having independent board members has the potential to add value to the decision making process and improve the overall performance of the trustee board. However, others would argue that forcing boards to have independent directors could, if anything, result in less discursive boards and, ultimately, potentially inferior decision-making.[1] In practice, trustee boards of superannuation funds can be made up of executives/management of the financial institution that promotes or sponsors the fund. If equal representation applies, employer representative directors may be appointed by employer-sponsors, while member representatives may be elected by members or nominated by trade unions or other representative bodies of the membership. Trustee boards can also include individuals employed by a material service provider, consultant or professional adviser to the superannuation fund.

Some trust deeds and/or company constitutions permit the appointment of an independent director, although under the SIS Act an independent director does not have a casting vote.[2] Nevertheless, such a director may be useful in bringing additional independent judgement to the trustee board, as well as filling any gaps that may exist in the overall skills and experience of the board.

Currently, the SIS Act allows equal representation rules to be met if the trustee board includes one independent director who has no casting vote.[3] APRA can modify the operation of the equal representation rules to allow a trustee board to appoint more than one independent director. However, without such a modification from APRA, trustee boards complying with the equal representation rules cannot, at this time, appoint more than one independent director.

Subject to "Fit and Proper" guidelines there are no other mandatory requirements as to the composition, tenure or independence of board members except that a majority of directors must be ordinarily resident in Australia.

APRA has provided the following guidance regarding board composition in Superannuation Prudential Guidance SPG 510 Governance:

- For a board to be sound it must act independently – demonstrated by a board that discharges its review and oversight role effectively and independent of the interests of dominant shareholders, management, and competing or conflicting business interests.
- An equal representation board might consider the benefits of the appointment of at least one "independent" director, as defined in section 10(1) of the SIS Act.

[1] Professor Sally Wheeler, Professor in the Faculty of Law, Queen's University Belfast – presentation to ASFA Sydney and Melbourne luncheon series, August 2013.
[2] Where equal representation applies.
[3] SIS Act, section 89(2)

- A non-equal representation board might consider the benefits of the appointment of at least one director who is free from any business or other association that could materially interfere with the exercise of their independent judgement (i.e. a totally independent or "non-affiliated" director). An independent director within the group is not considered non-affiliated.

- A prudent trustee would consider the appointment of an independent or non-affiliated director as Chair of the board.

Notwithstanding the lack of prescription regarding board composition in the relevant laws, board composition is affected by the requirement for a number of mandatory board committees. Under Superannuation Prudential Standard SPS 510 Governance:

- Unless exempted by APRA, a trustee must have a board remuneration committee. This committee must have at least three members. All members of the committee must be non-executive directors.

- The trustee must have a board audit committee. This committee must have at least three members. All member of the committee must be non-executive directors. The Chair of the trustee board cannot be chair of this committee.

[A reference to a "non-executive director" is a reference to a director who is not a member of the trustee's management team. Non-executive directors may include members of the board or senior managers of the parent company of the trustee company or of one of the parent company's subsidiaries, but they cannot be an executive of the trustee company itself.]

As such:

- Trustee boards are required to have at least 3 non-executive directors in order to comply with SPS 510 in relation to committee structure; and

- Under the relevant APRA guidance (SPG 510) it would be beneficial to have at least one non-affiliated director on the board and for that person to be the Chair.

ASFA recognises that the SIS Act would need to be amended to allow trustee boards that comply with the equal representation rules to appoint more than one independent director.

ASFA is currently considering the Coalition's position that at least one-third of the directors on superannuation boards of public offer funds should be independent.

Consultation questions:

3.1 Do you believe that trustee boards should consider the appointment of a number of independent/non-aligned board members, subject to appropriate changes being made to the SIS Act (as per question 3.2 below)? If so, what is an appropriate/ideal number?

3.2 Should the SIS Act be amended to allow trustee boards that comply with the equal representation rules to appoint more than one independent board member?

3.3 What is your view of the proposition that, rather than enforcing structural tests of independence, in order to improve governance greater focus should be placed on the skills/experience of board members, the quality of interaction between board members and overall decision-making process of the board?

3.4 What benefits and/or challenges do you believe would the appointment of multiple independent board members deliver to superannuation funds (or specific industry sectors)?

3.5 What is your view regarding the appropriateness or otherwise of the Coalition's position that at least one-third of the directors on superannuation boards should be independent?

3.6 What other independence issues currently exist and how can these be addressed?

3.2 Definition of independence

The SIS Act defines "independent director" and "independent trustee" as follows:

"Independent director", in relation to a corporate trustee of a fund, means a director of the corporate trustee who:

(a) is not a member of the fund; and

(b) is neither an employer-sponsor of the fund nor an associate of such an employer-sponsor; and

(c) is neither an employee of an employer-sponsor of the fund nor an employee of an associate of such an employer-sponsor; and

(d) is not, in any capacity, a representative of a trade union, or other organisation, representing the interests of one or more members of the fund; and

(e) is not, in any capacity, a representative of an organisation representing the interests of one or more employer-sponsors of the fund".

"Independent trustee" in relation to a fund, means a trustee of the fund who:

(a) is not a member of the fund; and

(b) is neither an employer-sponsor of the fund nor an associate of such an employer-sponsor; and

(c) is neither an employee of an employer-sponsor of the fund nor an employee of an associate of such an employer-sponsor; and

(d) is not, in any capacity, a representative of a trade union, or other organisation, representing the interests of one or more members of the fund; and

(e) is not, in any capacity, a representative of an organisation representing the interests of one or more employer-sponsors of the fund.

SIS also provides that, "[f]or the purposes of paragraph (b) of the definition of independent director … a director of a corporate trustee of a fund that is also an employer-sponsor of the fund is not taken to be an associate of that employer-sponsor by reason only of being such a director".

In the case of public companies, independence is achieved by having a majority of independent directors, who have no executive or commercial links with the management of the company.

There are some differences between corporations and superannuation funds; however, the ASX Corporate Governance Principles and Recommendations (ASX Principles) provide an insight into how this matter is addressed with respect to corporate governance.

The ASX Principles define an independent director as being "a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with - or could reasonably be perceived to materially interfere with - the independent exercise of their judgement".

The ASX Principles also identify relationships affecting independent status, stating that, when determining the independent status of a director, the board should consider whether the director:

1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company;
2. is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
3. has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
5. has a material contractual relationship with the company or another group member other than as a director.

ASFA's view is that neither the SIS Act nor the ASX Principles, on their own, adequately reflect the appropriate characteristics of independence that is required in the context of superannuation trustee boards. As such, ASFA has developed a more comprehensive definition of independence which we believe is better suited to the needs of the superannuation industry in the post-reform world.

Proposed alternative definition:

An individual should be taken to be 'independent' in the context of a superannuation fund trustee board if he/she has not, in any capacity within the last three years, been employed by the fund, an employer-sponsor of the fund, a sponsoring organisation, a material service provider/consultant/professional adviser to the fund or any organisation representing the interests of one or more members or employer-sponsors of the fund (nor an associate of any such entities, as defined in section 10 of the SIS Act).

For the avoidance of doubt, a sponsoring organisation includes a financial institution operating a public offer fund.

It should be noted that, in the proposed definition above, we have suggested the removal of the requirement for an individual not to be a member of the fund in order to be considered independent (which currently forms part of the SIS Act definition). It can be argued that, being a member of a superannuation fund is not, and should not be, a determining factor with respect to independence and the positive impact that independence on trustee boards can bring. That is, being a member of the fund arguably has the potential to create incentives for individuals to do their utmost to ensure that the best possible outcomes for all fund members is achieved as a result of having 'skin in the game'.

Although a similar argument for the 'non-exclusion' of fund members from the proposed alternative definition of independence can also be made for, say, employer-sponsor or union representatives, we would argue that employer/union representatives would typically have a greater capacity to exert influence on the trustee board than an individual who just happens to be a member of the fund. For this reason, we believe it is appropriate to exclude employer/union representatives (just as those who are employed by a sponsoring organisation or a material service provider, consultant or professional adviser to the fund have been excluded) from the definition of 'independent'.

This view is reflected in the proposed alternative definition above, however we are interested in the views of ASFA members on the appropriateness, or otherwise, of this proposition.

Consultation questions:

3.7 Do you support the proposed (more comprehensive) definition of 'independence' outlined above as one that is better suited to the needs of the superannuation industry in the post-Stronger Super reform world? Or do you believe the SIS legislation definitions of "independent director" and "independent trustee" adequately deal with this?

3.8 Do you agree with the removal from the definition of the requirement for an individual not to be a member of the fund in order to be considered independent? Please provide the basis for your response.

4 Role of the Chair

The performance of the Chair is critical to the effective operation of the trustee board. It is preferable that the Chair is a strong leader, independent of sponsors and appointer interests.

While the specific duties of the Chair will vary from fund to fund, they typically include:

- providing leadership to the trustee board;
- ensuring that the trustee board satisfactorily fulfils its functions;
- managing meetings of the trustee board to ensure that all necessary decisions are made, and to facilitate the effective contribution of all trustee board members;
- liaising between the trustee board and the CEO;
- guiding the development of individual board members and the trustee board as a whole;
- ensuring that the trustee board regularly evaluates its own performance; and
- ensuring that an effective secretariat is in place.

The importance of the role played by the Chair in ensuring the effectiveness of a trustee board cannot be overstated. The trustee board should therefore consider the characteristics it seeks in a Chair and devise suitable procedures for the Chair's appointment. The procedures should include succession planning mechanisms capable of dealing with both planned and unplanned exits by a current Chair. These mechanisms could include:

- appointment of a Deputy Chair, with the expectation that the Deputy will succeed as Chair;
- training opportunities for potential Chairs, including service as Chair of a key committee;
- a process for evaluating the performance of the Chair; and
- a process for the rotation or removal of the Chair.

Although not strictly a requirement under the legislation or the superannuation prudential standards, from a best practice perspective we highly recommend that a trustee board documents the duties of the Chair and establishes appropriate appointment procedures, including a mechanism for succession planning.

In addition, our view is that the Chair should have the ability to vote and have the casting vote if necessary. That is, after all the votes on an issue have been counted (including that of the Chair) and the votes on each side are equal, the Chair should be given an *extra* vote to decide the issue.[4] Although the need for a casting vote may not be an issue in most situations, because there is consensus around the board table, or a clear majority view, on matters being considered, we believe it would be prudent for trustee boards to have a mechanism in place for dealing with situations

[4] Under SIS Regulation 4.08, where equal representation applies, a decision of the trustee board "must be taken not to have been made, or to be of no effect, if fewer that two-thirds of the total number of trustees or directors, as the case requires, voted for it". As such, where equal representation applies, it may be that it is not possible for a deadlock to arise in the first place as a result of decisions by the trustee board requiring a two-thirds majority (in which case the ability for the Chair to have a casting vote would not be as important).

where there is an equal number of votes recorded for and against. As stated in section 3.1, it should be noted that a casting vote is currently prohibited under the SIS Act.

From a good governance perspective, we believe that the roles of the Chair and Chief Executive Officer should not be exercised by the same individual.

Consultation questions:

4.1 Should trustee boards be required (in the prudential standards or elsewhere) to document the duties of the Chair and establish appropriate appointment procedures, including a mechanism for succession planning? Or is this better addressed in the prudential guidance?

4.2 Do you support the proposition that the roles of the Chair and Chief Executive Officer should not be exercised by the same individual? If so, does this requirement need to be enshrined in legislation or stipulated in the prudential standards?

4.3 Do you support the proposition that the Chair should have the ability to vote and have a casting vote if necessary (i.e. an extra vote to break a deadlock on an issue)?

5 Trustee board structure

The structure of the trustee board will be dictated by its governing rules[5] and the regulatory framework. For example, from 1 July 2013 it is a regulatory requirement that all 'responsible persons', including members of the trustee board (whether they are directors or individual trustees), must meet the requirements of Superannuation Prudential Standard SPS 520 – Fit and Proper. Each trustee board must have a Fit and Proper Policy specifying its requirements for meeting the prudential standard.

Where the composition of the trustee board is determined by someone else (for example, by sponsoring organisations), the trustee board should provide some input into the selection process (for example, by communicating its desired qualities or skills in a candidate) and so assist in ensuring that high quality individuals are appointed to this important and demanding role.

The trustee board should be structured in such a way that it:

- understands and competently deals with all major issues relevant to the fund;
- exercises independent judgment;
- encourages enhanced performance; and
- effectively reviews and challenges the performance of management.[6]

5.1 Size of trustee boards

Consideration needs to be given by each trustee board to the appropriate number of directors required on the board to provide sufficient expertise whilst still maintaining an efficient governance and decision making framework.

Trustee boards should have a 'balanced' representation wherever possible. But what is an optimal size for a superannuation trustee board? Or indeed, is there an optimal size (or range)?

Research has been conducted by the Melbourne Institute of Applied Economic and Social Research (The University of Melbourne) on the optimal size of boards. Results published in their paper[7] indicate that, whilst empirical research on board size is relatively uncommon, two studies cited found that the average board size across a sample of 452 US firms over an eight-year period (1984-1991) was 12.25.

In addition, research undertaken by Jensen (1993)[8] and Lipton and Lorsch (1992)[9] shows that as board size increases it becomes difficult for an additional director to increase value. A larger board negatively affects the amount of time available at typical board meetings, and has a negative impact by leading to greater formality and less frankness and openness on strategic discussions. As such, a

[5] Including, for a corporate trustee, its constitution.
[6] *ASX Corporate Governance Principles and Recommendations*, page 16.
[7] University of Melbourne (1997), Executive Remuneration, Board Structure, Corporate Strategy and Firm Performance: A Taste of the Literature
[8] Jensen, M. (1993), The modern industrial revolution, exit, and the failure of internal control systems
[9] Lipton, M. and Lorsch, J.W. (1992), A modest proposal for improved corporate governance

larger board may not in fact be an effective board in that it may be less cohesive and more likely to endure individuals who add little value. The authors of the abovementioned research therefore recommend limiting the sizes of boards to ten people with a preferred size of eight or nine.

However, a more recent study out of the University of Canberra[10] suggests that there is no consensus on what the ideal board size actually is. Some examples of the inconsistencies thrown up by the various research results cited within this study include observations that:

i) Eight directors should be the upper limit, and the mean board size is 6.6[11]

ii) Eight is "typical"[12]

iii) Eight to eleven is optimal[13]

iv) Six to nine is current good practice in the private sector (but this may differ from organisation to organisation in the public sector)[14].

One of these research studies[7] suggests that there is an 'inverted U' relationship between board size and performance in which, beyond a certain point (tipping point), the difficult dynamics of large board prevail over the skills/expertise advantage that additional directors might bring. However, this same study also found evidence in the Australian context that large sized boards are not necessarily impediments to good performance. Yet another study on company boards[15] asserts that, for certain types of firms, larger boards actually increase firm value.

In summary, the results of the various studies into optimal board size and the effectiveness or otherwise of larger boards as compared to smaller boards are mixed and inconclusive.

It should be noted that one of the factors that contribute to large boards is when a merger of funds occurs, as a consequence of the 'transfer' of the merging funds' board members into the merged fund's board. This often results in inflated board numbers, which usually reduces over time.

ASFA endorses the ASX Principles but recognises that funds need the flexibility to determine that a larger number of directors may be valuable given their specific circumstances. In particular, trustee boards need to have a sufficient number of members to enable the effective operation of a trustee board's committee structure and to ensure that the required skills and a variety of perspectives are incorporated into the trustee board.

Trustee boards need the flexibility to be able to create a structure that is the most effective for their fund and its particular circumstances. In order to do so, trustee boards need discretion as to their size.

[10] University of Canberra (2005), Corporate Governance and Performance: An Exploration of the Connection in a Public Sector Context
[11] Kiel, G.C. and Nicholson, Gavin J (2003), Board Composition and Corporate Performance: How the Australian Experience Informs Contrasting Theories of Corporate Governance
[12] Larcker, D.F., Richardson, S.A., Tuna, I. (2004), Does Corporate Governance Really Matter
[13] Leblanc, R. and Gillies, J. (2004), Improving Board Decision-Making: An Inside View. Alternatives Beyond Imagination
[14] Uhrig, J. (2003), Review of the Corporate Governance Arrangements of Statutory Authorities and Office Holders
[15] Coles, J.L., Daniel, N.D., Naveen, L. (2003), Boards: Does one size fit all?

Consultation questions:

5.1 Do you support the position that trustee boards need the flexibility to be able to create a structure that is the most effective for their fund and, as such, need discretion on the size of their trustee board? Please provide the basis for your response.

5.2 If you do not support this position, what should be the upper (and lower) limit on the number of directors a superannuation trustee is allowed to have?

5.3 In your view, what is the preferred/ideal number (or range) of directors for a superannuation fund?

5.4 Where a merger of funds occurs, resulting in inflated board numbers in the merged fund, would it be appropriate to require the merged fund's board to set a target number of directors and a target date for achieving that number?

5.2 Characteristics of effective boards

Board composition is one of the most important components of a successful trustee board. It is important for the successful operation of a trustee board that individuals appointed to the board are effective in their roles and have the ability to work well together and with management.

Effective board membership requires high levels of intellectual ability, experience, soundness of judgement and integrity. There is also the question of the collective capacity of the board in terms of the mix of abilities/skills, experiences and personality that best makes up the board as a collective body. There are several key components common to highly effective boards including:

1. Diversity
2. Good strategic planning
3. Appropriate mix of skill sets
4. Board member commitment
5. Board member engagement.

Successful and effective trustee boards possess many of these qualities.

This section focuses specifically on the first and third components listed above and explores what is an appropriate mix of skill sets that would ideally be present in an effectively operating superannuation trustee board, recognising that diversity of age, experience, personality, culture etc between board members can often lead to more effectively functioning trustee boards and improved outcomes for fund members. (Gender diversity is discussed separately in Section 6.)

Trustee boards should have a 'balanced' representation wherever possible. This will enable trustee boards to better communicate with, and understand the needs of, the different demographic groups within their fund's membership.

Also, trustee boards should ensure that there is an appropriate mix of individuals on the board with the appropriate skills relevant to the needs of their fund. The degree to which this can readily be achieved could, in turn, impact on the number of board members that are ultimately required (as discussed in

Section 5.1 above). That is, issues of board size and appropriate mix of skills/experience are to some degree inherently interlinked.

Paragraph 11 of Superannuation Prudential Standard SPS 510 – Governance states that:

> "The Board must ensure that the directors and the senior management of the RSE licensee, collectively, have the full range of skills needed for the effective and prudent operation of the RSE licensee's business operations, and that each director has skills that allow them to make an effective contribution to Board deliberations and processes. This includes the requirement for directors, collectively, to have the necessary skills, knowledge and experience to understand the risks of the RSE licensee's business operations, including its legal and prudential obligations, and to ensure that the RSE licensee's business operations are managed in an appropriate way taking into account these risks. This does not preclude the Board from supplementing its skills and knowledge by engaging external consultants and experts."

In addition, new SIS Regulation 2.38(2)(j)(ii) requires trustee boards to make publicly available on the fund's website the qualifications of each executive officer or individual trustee as part of the 'systematic transparency' measures.[16]

It is important that trustee boards have sufficient experience and expertise so as not to have to rely solely on advice received from external parties (eg. professional advisers, service providers etc).

Each trustee board has their own matrix of skills as each board member brings different areas of expertise to the collective. Many boards undertake wide ranging trustee training, often of the whole board. This includes general superannuation education such as specialised conferences, specific topic seminars, and formally assessed training courses.

However, whilst each board member brings to the trustee board their own set of skills (eg. general business acumen, accounting, financial insight etc), it is important to ensure there are minimum competency standards and expertise for all trustee board members (particularly in relation to governance) for the protection, not only of fund members, but also of the board members. Trustee boards have a duty to seek advice where required, however, seeking and relying on advice is often not sufficient. There needs to be sufficient experience and expertise to ensure that directors can understand and, where necessary, challenge the advice provided by external parties.

Investing the assets of the superannuation fund is a major part of a trustee board's responsibilities. Superannuation trustee boards have an obligation to ensure that superannuation monies are invested prudently. As such, a trustee board needs to ensure that it has a number of board members with sufficient investment expertise to ensure the board can have a proper debate about investment matters and make informed investment decisions, without the need to not rely solely on the advice of external investment managers or internal investment personnel.

[16] SIS Regulation 2.38 was intended to start on 1 July 2013 but has been deferred by Class Order until 31 October 2013. There is also a possibility of a further extension until 31 December 2013.

As well, it is important for trustee boards to regularly monitor their diversity of skills, knowledge and experience. Since no single person can provide all the qualities/skills required for an effective board, and because the needs of the fund will continually change, a trustee board should have formalised and well developed processes to identify and assess the competencies of its board members, both individually and as a collective.

In addition, trustee boards need to undertake regular (i.e. at least annual) analysis of the board's collective skills/expertise to identify any gaps that may exist. Where gaps are identified, these need to be rectified as soon as possible – i.e. through training and upskilling of current directors and/or as part of the trustee board's renewal process.

On an ongoing basis, the trustee board can add further value and improve its governance of the fund through mechanisms such as training[17], explicit statements of expectations, performance reviews and appropriately dealing with any failure to comply with its Fit and Proper Policy.

Consultation questions:

5.5 In addition to investments, are there any other areas in which all trustee boards should collectively have sufficient levels of expertise or prior experience (superannuation knowledge, finance/business, legal, audit/risk/compliance, insurance etc)?

5.6 What challenges, if any, do trustee boards face in identifying and assessing the competencies of their board members, both individually and as a collective?

5.7 Where gaps are identified in the skills or expertise of board members, what challenges do trustee boards face in rectifying these gaps (through training, upskilling etc) in a timely manner? What other rectification strategies/activities have proven effective?

[17] ASFA's views on trustee training and induction are not discussed in the paper. For more information on this issue, refer to *ASFA Best Practice Paper No.7 – Superannuation Fund Governance* (version 4, October 2010).

6 Gender diversity

Although trustee boards, generally, have greater female representation than ASX listed companies[18], there is still considerable progress required in order to address the current gender imbalance. Data provided by the Women in Boards 2012 Boardroom Diversity Index shows that:

- 21.8 per cent of directorships of corporate trustees are held by women
- 19 per cent of trustee companies do not have a woman on their board
- 50 per cent of trustee companies have at least 25 per cent women on their board (but only 7 per cent of trustee boards have at least 50 per cent women).

According to the Super System Review[19], the goal should be at least 40 per cent.

In the listed company space, the ASX Principles suggest that companies should establish a policy concerning diversity and disclose the policy or a summary of that policy.[20] The policy should include requirements for the board to establish measurable objectives for achieving gender diversity. The board should assess annually both the objectives and progress in achieving them.

ASFA supports the overall aim of achieving greater gender diversity on trustee boards and the ASX Principles supporting this goal. Specifically, we recommend that trustee boards consider ways to promote a culture which embraces gender diversity when determining the composition of the board and set a measurable medium-to-long term goal with respect to female representation and disclose annually to members on how they are tracking against that goal.

At present, trustee boards are not required to set any goals with respect to female representation. Where such a goal exists, trustee boards are not required to disclose this target to their members nor how they are tracking against it.

From a best practice perspective, we highly recommend that trustee boards conduct an objective assessment of their composition in line with the revised ASX Corporate Governance Principles and Recommendations on diversity, including gender diversity. In particular, we recommend that trustee boards consider setting a medium-to-long term goal with respect to female representation – for example, achieving 40 per cent female representation on their board over a period of, say, 7 years – and disclose annually to members how they are tracking against that goal or if that goal has changed for any reason.

In addition, if they do not have any women directors, our view is that trustee boards should disclose to members why this is the case.

[18] Women on Boards 2012 Boardroom Diversity Index

[19] Super System Review: Final Report – Chapter Two: Trustee governance (2010, p.64)

[20] The proposed 3rd edition (consultation draft) of the ASX Principles, which is in the process of being consulted upon prior to release, focuses on diversity in general, including gender diversity with respect to the proportions of men and women on the board, in senior executive positions and across the whole organisation.

Consultation questions:

6.1 Should trustee boards have to conduct an objective assessment of their composition, including gender diversity, and set medium-to-long term goals with respect to female representation? Should a broader definition of diversity be considered by trustee boards (i.e. in addition to gender diversity)?

6.2 Do you believe 40 per cent female representation on trustee boards is an appropriate/achievable target for the superannuation industry? If so, what is an appropriate timeframe that funds should set to achieve such a target? If not, what is an appropriate/achievable target in your view?

6.3 What impediments currently exist, if any, that would prevent a fund (or the industry in general) from achieving such a target? How can such impediments be overcome?

6.4 For funds with equal representation, whose members are predominantly male or female, would a requirement to set and disclose a target on female representation pose any significant challenges for the fund or its members?

6.5 Should trustee boards be compelled to disclose to their members how they are tracking against their target on female board representation and, if they have no women directors, disclose why this is the case? If so, what is the best way to disclose this information to members (method, frequency etc)?

6.6 If you believe that setting an industry-wide goal of achieving greater female representation on trustee boards is appropriate, how can such a goal be realised?

7 Performance and competency

There are two levels of trustee board performance that need to be considered:

- performance of the individual board members; and
- performance of the trustee board as a whole.

Good governance requires the trustee board to monitor and review not only the performance of management and material service providers, but also to assess the effectiveness of its governance of the fund.

Superannuation Prudential Standard SPS 510 states that "[t]he Board must have procedures for assessing, at least annually, the Board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of individual directors."[21] ASFA supports this requirement as it is essential that performance is measured objectively by a trustee board review process and that any imbalance or underperformance is promptly detected and remedied. To achieve this trustee boards need to have a process of assessing an individual director's performance as well as the performance of the trustee board as a whole.

The trustee board should first devise clear performance objectives and standards, and then ensure that performance is evaluated against the agreed objectives/standards.

Prudential Practice Guide SPG 510 provides examples of objectives that could be set for the trustee board and for individual board members.[22]

Performance standards could be framed around issues such as:

- the degree of successful achievement of the fund's strategic objectives;
- the extent to which the trustee board has adhered to its own governance policies;
- whether material decisions have been made on a fully informed basis, and after adequate discussion;
- whether all members have been given equal opportunity to provide input into the decision-making process;
- whether decision-making has been influenced by outside allegiances, rather than being based only on the interests of fund members;
- whether the trustee board's ability to function in a productive manner has been reduced by personality clashes or political differences within the board; and
- whether the trustee board has contributed to the effective management of strategic risks.

[21] Superannuation Prudential Standard SPS 510 – Governance, paragraph 19.
[22] SPG 510 – Governance, paragraphs 23 and 24.

One approach is for each board member to individually assess the trustee board's performance against a range of measures, followed by a collective discussion and review by the trustee board as a whole. A potential alternative is to employ a consultant to provide an independent review of how well the trustee board functions. The issue of a person or persons who dominate the decision making process of the trustee board should be addressed in this annual review. Those who passively 'follow the leader' need to understand that this sort of contribution falls short of their fiduciary obligations.

Any concerns that are identified as part of this annual performance assessment must be dealt with. In most cases, this can be part of the normal planning process. However, specific consideration needs to be given to how the trustee board will deal with any significant areas of dysfunction. This may involve specific training in areas such as the duties of trustees, participating in trustee board meetings and/or conflict resolution skills. It may also require the trustee board to provide feedback to organisations that have input into trustee board appointments about any gaps that have emerged in the collective skill set of the board.

To ensure the annual performance assessment process is effective in its ability to remedy any imbalance or underperformance, it is imperative that trustee boards have the ability to remove non-performing directors.

A trustee board is required under the legislation to take reasonable steps to satisfy itself that a person holding, or proposed to hold, a responsible person position is not a disqualified person within the meaning of section 120 of the SIS Act.

In regards to employer-sponsored funds, there are also requirements under the SIS Act and Regulations that specify that independent and member-representative board members can only be removed in the same manner as they were appointed, except in certain circumstances (such as death, mental or physical incapacity etc).[23] Also, new SIS Regulation 2.38(2)(c) requires funds to make the rules for appointment and removal of trustee directors publicly available on the fund's website as part of the 'systematic transparency' measures.[24]

In addition, Superannuation Prudential Standard 520 requires a trustee board's Fit and Proper Policy to specify the actions to be taken where a person is assessed as not being fit and proper.[25] In particular, paragraph 43 of SPS 520 states that "[w]here an RSE licensee has assessed that a person is not fit and proper, or a reasonable person in the RSE licensee's position would make that assessment, the RSE licensee must take all steps it reasonably can to ensure that the person:

(a) is not appointed to; or

(b) for an existing responsible person, does not continue to hold

the responsible person position."

[23] SIS Act, sections 107 and 108; SIS Regulations 4.06 and 4.07

[24] SIS Regulation 2.38 was intended to start on 1 July 2013 but has been deferred by Class Order until 31 October 2013. There is also a possibility of a further extension until 31 December 2013.

[25] Superannuation Prudential Standard SPS 520 – Fit and Proper, paragraph 27.

Consultation questions:

7.1 Other than as a result of being a disqualified person or failing the fit and proper test, from a good governance perspective are there other factors that trustee boards should consider in determining whether to remove non-performing board members (eg. unresolved conflicts, lack of engagement due to time constraints, non-contribution or overly dominating, ongoing health issues or any other reasons)?

7.2 Is greater prescription required to specify the various factors that should be considered by trustee boards in assessing performance/underperformance of individual directors? If so, what should these factors include (and what exceptions should be put in place with respect to these factors)?

7.3 Should the SIS Act and Regulations be amended to remove the requirement that independent or member-representative directors generally can only be removed in the same manner they were appointed?

7.4 What challenges, if any, do trustee boards face in being able to remove non-performing directors? How can these challenges be overcome?

7.5 How can/do trustee boards deal with any areas of dysfunction in order to improve the competency/performance of individual directors and/or the overall functioning of the board?

8 Remuneration

Superannuation Prudential Standard SPS 510 Governance includes a range of requirements relating to remuneration arrangements within the trustee board's business operations. These include:

- Maintaining a documented Remuneration Policy approved by the trustee board; and
- Establishing a Board Remuneration Committee that complies with the requirements of SPS 510.

8.1 Remuneration Policy

SPS 510 states that "[t]he Remuneration Policy must outline the remuneration objectives and structure of the remuneration arrangements, including, but not limited to, the performance-based remuneration components of the RSE licensee."[26]

These performance-based components of remuneration must be designed to encourage behaviour that supports protecting the interests, and meeting the reasonable expectations, of beneficiaries and ensures the long term financial soundness of the fund. Remuneration should be aligned with prudent risk-taking.

The remuneration arrangements in the trustee board's Remuneration Policy need to address measures of performance, the mix of forms of remuneration (such as fixed and variable components, and cash and equity related benefits) and the timing of eligibility to receive payments. Importantly, all forms of remuneration are captured by SPS 510, regardless of where, or from whom, the remuneration is sourced.

ASFA supports the requirements that trustee boards must maintain a documented Remuneration Policy that meets all of the requirements of SPS 510 and covers all persons or classes of persons required under paragraph 27 of SPS 510.

Further, ASFA is supportive of the requirement that trustee boards must undertake a review of their Remuneration Policy at least every three years.

Consultation questions:

8.1 Notwithstanding the fact that the obligation to maintain a documented Remuneration Policy approved by the trustee board is already a requirement under SPS 510, what challenges, if any, do trustee boards face in addressing all the relevant arrangements (eg. performance-based remuneration and its alignment with prudent risk-taking, fixed/variable components, sources of remuneration etc) within their Remuneration Policy?

8.2 What other challenges, if any, do trustee boards face in terms of complying with this requirement?

8.3 Is three years an optimal period of time in which to review the trustee board's Remuneration Policy or could such a review, in your opinion, be adequately undertaken more/less frequently?

[26] Superannuation Prudential Standard SPS 510 – Governance, paragraph 21.

8.2 Disclosure of remuneration

It is important that trustee board members are appropriately remunerated in respect of their services to the fund and properly incentivised to apply themselves to the task and duties of a trustee board member.

APRA recognises that "remuneration objectives are likely to relate to attracting and retaining staff. APRA's remuneration requirements and guidance relate to managing or limiting risk incentives associated with remuneration. They are not intended to affect business decisions regarding pay levels or limit innovative methods of rewarding staff, provided such measures do not compromise the requirements of SPS 510".[27]

The *Corporations Act 2001* requires listed companies to disclose the nature and amount of each element of the fee or salary of each director for the performance of their director role, and each of the five highest paid officers of the company. A number of trustee companies are moving in this direction, largely because of a desire to be consistent with their expectations of companies in which they invest.

Given the Australian superannuation pool is now the fourth largest pension pool in the world at $1.62 trillion[28], which is roughly equivalent to our annual GDP and projected to increase to around $5.5 trillion by 2030, there is an increasing need for appropriate levels of transparency around remuneration and a greater focus on prudent risk-taking.

The *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (MySuper tranche 3) has introduced an obligation in the SIS Act[29] that requires trustee boards to ensure that the following is made publicly available, and kept up to date, at all times on the fund's website:

(i) If the trustee is a body corporate, the remuneration of each executive officer in relation to the fund; and

(ii) If the trustee is a group of individuals, the remuneration of each trustee of the fund.

ASFA is supportive of the nature and amount of remuneration paid to trustee directors being disclosed on the fund's website. The disclosure needs to comply with the requirements of the regulations, and should cover both cash and non-cash benefits and show amounts paid to trustee directors by the fund and amounts paid to directors by others for their services to the fund.

It should be noted that the Coalition have stated that "[d]isclosure of conflicts of interest should be and must be mandatory, and directors of superannuation funds must disclose their remuneration in line with the provisions that apply for publicly listed companies and other APRA regulated sectors".[30]

[27] Draft Prudential Practice Guide SPG 511 – Remuneration, paragraph 4.
[28] APRA Quarterly Superannuation Performance Statistics (June 2013), issued 22 August 2013
[29] SIS Act, Section 29QB and SIS Regulation 2.37
[30] Adjournment Speech in the Senate, "Certainty & Stability in Superannuation under the Coalition", given by Mathias Cormann on 6 February 2013.

Consultation questions:

8.4 What challenges, if any, exist in trustee boards having to disclose on the fund's website both the nature and amount of remuneration paid to trustee directors?

8.5 Does the fact that this disclosure needs to cover both cash and non-cash benefits and show amounts paid to trustee directors by the fund as well as amounts paid by others for services to the fund pose any significant difficulties?

8.6 The regulations require a trustee board to disclose, for each executive officer, the percentage of the bonus or grant for the financial year that was forfeited because the person did not meet the service and performance criteria. Does the disclosure of such potentially sensitive information pose a challenge for funds (particularly as there are a multitude of different reasons why a bonus might not have been paid, but these will not be apparent from the disclosure)?

8.7 The list of remuneration items to be disclosed is extensive. It includes short term employee benefits such as salary, fees (eg. director fees), bonuses and profit sharing, post-employment benefits such as pensions and superannuation benefits, other long-term employee benefits, signing on bonuses and share based payments. Are these remuneration items sufficiently clear or do some elements need to be defined/clarified? Would the provision of examples be of assistance?

9 Tenure

Superannuation Prudential Standard SPS 510 states that "[t]he Board must have in place a formal policy on Board renewal. This policy must provide details of how the Board intends to renew itself in order to ensure it remains open to new ideas and independent thinking, while retaining adequate expertise. This policy must give consideration to whether directors have served on the Board for a period that could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of beneficiaries. The policy must include the process for appointing and removing directors, including the factors that will determine when an existing director will be reappointed."[31]

Furthermore, the accompanying Prudential Practice Guide[32] states that "[i]t would be prudent for a Board's renewal policy to document the maximum tenure period for all directors, including the circumstances where the RSE licensee may step outside the terms of its tenure policy". The guidance goes on to state that "APRA expects that the circumstances where a person is reappointed at the end of a reasonable total period of tenure would be exceptional".

The advantages of setting maximum tenure periods include:

- A regular infusion of fresh ideas and new perspectives is brought onto the trustee board.
- It eliminates the sense of entitlement for those who wish to retire into a directorship.
- Incoming board members know that their contribution and commitment has to be made within a limited timeframe.
- Managing diversity is made easier through regeneration of the board whilst the membership of the trustee board can be continuously replenished.
- The trustee board has a built-in balance of continuity and turnover.
- Passive, ineffective or troublesome board members can more easily be rotated off.
- Trustee boards without maximum limits, and therefore numerous long-serving members, can experience stagnation, perpetual concentration of power within a small group, diminished debate over critical issues, potential alienation and even intimidation of the occasional new board member, tiredness, boredom and loss of commitment by the board.

The disadvantages of setting maximum tenure periods include:

- There is a risk that large portions of expertise could be lost at one time if board succession planning is not managed effectively.
- It is important to have an experienced board member with a good corporate memory, who has witnessed recurrent trends and cycles over time.

[31] Superannuation Prudential Standard SPS 510 – Governance, paragraph 20.
[32] SPG 510 – Governance, paragraph 29.

- By prescribing an arbitrary period of time, the ability to take account of the individual circumstances of a trustee board could be limited – for example, the loss of a key person or the ability of that board to replace a director with another person of similar expertise, knowledge and experience.

Whilst ASFA recognises that the imposition of maximum tenure may be an issue for some trustee boards, as this could result in good trustees being lost, we believe that the advantages resulting from the regular replenishment of board members and their fresh ideas and thinking outweigh any disadvantages.

Also, the introduction of maximum tenure periods would likely result in experienced trustees moving from one fund's trustee board to another at the end of their tenure. This would not be an undesirable outcome since it would lead to the sharing of ideas, skills and expertise gained from previous trustee board appointments.

ASFA supports the guidance provided in SPG 510 that a trustee board's renewal policy should document the maximum tenure period for all directors. In particular, we recommend that a trustee board consider whether it would be appropriate, in its particular circumstances, to implement a maximum tenure period for its trustee directors.

A trustee board's tenure policy needs to recognise that, unlike shareholders of a company, members of a superannuation fund do not have the capacity to remove trustee directors.

ASFA suggests that best practice would be for trustee boards to consider implementing a policy which includes a maximum tenure on boards by way of fixed renewable terms. Such a policy would be recommended but not made compulsory. It would be up to each trustee board to determine whether such a policy would be effective in its situation.

For example, a common pattern in corporate boards is to have a 5-year term with an optional additional 5-year term, with a maximum of 2 terms, but directors could serve again after a given period of time off the board. Another common approach is to have multiples of 3-year terms up to a maximum of, say, 3 or 4 terms.

Such arrangements could be supported by a comprehensive succession planning process.

Consultation questions:

9.1 Do you agree with the advantages and disadvantages of setting maximum tenure periods that have been listed? Are there any other advantages or disadvantages that you believe exist which have not been listed?

9.2 Do you support the view that the advantages of setting a maximum tenure on boards (i.e. regular infusion of fresh ideas and perspectives etc) outweigh any disadvantages? If so, what is an appropriate number? If not, why not?

9.3 *In your view, would the introduction of maximum tenure requirements result in experienced trustee directors being lost to the industry? Or would it result, to some extent, in experienced trustee directors moving from one fund's trustee board to another at the end of their tenure?*

9.4 *Would setting fixed renewable terms (eg. 3-year renewable terms subject to a maximum of 3 or 4 terms) be a practical way for a fund to implement a maximum tenure period? If not, how else could such an outcome be achieved?*

9.5 *Are there any implications around a trustee board having to specify the circumstances where it may step outside the terms of its tenure policy?*

9.6 *Would you support a requirement that would limit the ability of directors to serve on boards based on a maximum age? That is, is age an appropriate measure/proxy for an individual's capability to serve as a trustee director or a suitable indicator that a director has been on a board for a sufficiently long period of time? If so, what would be an appropriate age limit in your view?*

9.7 *Alternatively, are there any other factors (other than age or health issues) that could serve as an appropriate measure/proxy for an individual's ability to serve as a trustee director? Or do you believe that a person's ability to serve as a trustee director should be measured solely on their performance and their ongoing capacity to perform their duties as trustee director?*

10 Conflicts of interest and duty

Trustee boards have a fiduciary obligation to act in the best interests of members and beneficiaries of the fund and not in their own interests or those of external parties. Trustee boards also have a general law duty to avoid placing themselves in a position where their duty to fund members conflicts with their personal interest (conflict of interest) or duty to someone else (conflict of duty).

New covenants in section 52 and 52A of the SIS Act require that trustee boards and directors must give priority to the duties owed to, and the interests of, beneficiaries over those of other persons, and must ensure that this duty of priority is met despite any conflict. In particular, section 52(2)(d) of the SIS Act requires trustee boards to:

- give priority to the duties to, and the interests of, beneficiaries over the duties to, and interests of, other person;
- ensure the duties of beneficiaries are met despite the conflict;
- ensure the interests of beneficiaries are not adversely affected by the conflict; and
- comply with the prudential standards in relation to the conflict.

Similar covenants on individual directors apply under section 52A(2) to perform their duties and exercise their powers in the best interests of beneficiaries.

As well, Prudential Standard SPS 521 Conflicts of Interest (SPS 521) requires trustee boards to have a conflicts management framework that is appropriate to the size, business mix and complexity of the fund's business operations and which applies to the entirety of its business operations.

SPS 521 also requires trustee boards to:

- develop, approve, implement and review a conflicts management policy;
- identify all relevant duties and relevant interests[33]; and
- develop and maintain up-to-date registers of relevant duties and relevant interests.

In addition, new SIS Regulation 2.38(2)(l) requires funds to make publicly available on the fund's website a register of relevant interests and a register of relevant duties.[34]

10.1 Conflicts management policy

A trustee board has a duty to ensure that the decisions of trustee board members are not conflicted or compromised.

Trustee boards should have a clear and transparent conflicts management policy in place to manage actual and perceived conflicts, and to avoid situations where conflicts of interest or conflicts of duty are so great that they cannot, in practice, be managed. The policy should include general principles to be used in managing different types of conflict which may arise from time to time. We believe the relevant

[33] 'relevant duty' and 'relevant interest' are both defined in SPS 521 Conflicts of Interest

[34] SIS Regulation 2.38 was intended to start on 1 July 2013 but has been deferred by Class Order until 31 October 2013. There is also a possibility of a further extension until 31 December 2013.

tests which trustees should apply include, "how would members perceive such a conflict?", "does it compromise open discussion at the board table?" and "does it impact on the board and directors' duties to act in the best interest of the fund's members?".

ASFA supports the current requirement that trustee boards need to formulate and document their conflicts management policy, including procedures for identifying, assessing and effectively managing actual and potential conflicts of interest or duty. This conflicts management policy needs to comply with the requirements of SPS 521 Conflicts of Interest and be reviewed comprehensively at least every three years.[35]

In addition, new SIS Regulation 2.38(2)(m) requires funds to make a summary of the trustee board's conflicts management policy publicly available on the fund's website as part of the 'systematic transparency' measures.[36]

Consultation question:

10.1 Are there any additional legislative or prudential requirements that can/should be introduced, over and above the current obligations under sections 52 and 52A of the SIS Act, SIS Regulation 2.38(2)(m) and SPS 521, that could potentially enhance the way in which trustee boards manage actual or potential conflicts? That is, are there any gaps or ambiguities in the current legislative and prudential requirements on conflicts that require further discussion?

10.2 Multiple trustee board membership

A not uncommon situation is that one individual is a trustee or director on more than one superannuation fund trustee board. There are also situations wherein a professional trustee company, where the same board (composed of the same directors) acts as the trustee for multiple funds, often including public offer funds that may be competing in the same space. Such situations lead to the potential for conflicts of interest and conflicts of duty to arise.

The key issues to consider with respect to such conflicts of interest or duty are:

1. Whether an individual who is on the trustee board of more than one APRA-regulated superannuation fund can properly fulfil their fiduciary duties;

2. Does the presence of that individual compromise discussion at board level?
   eg. whether their presence would impact on other board members' ability or willingness to discuss issues which may be commercially sensitive or involving proprietary information; and

3. What would fund members think of the presence of that individual?
   i.e. the perception of a conflict, which arguably can be as important as the existence of an actual conflict.

[35] SPS 521, paragraph 20.

[36] SIS Regulation 2.38 was intended to start on 1 July 2013 but has been deferred by Class Order until 31 October 2013. There is also a possibility of a further extension until 31 December 2013.

As stated above, new covenants in section 52 and 52A of the SIS Act require that trustee boards and directors must give priority to the duties owed to and interests of, beneficiaries over those of other persons, and must ensure that this duty of priority is met despite any conflict. This obligation takes priority over any conflicting obligations an executive officer or employee of a corporate trustee has under Part 2D.1 of the *Corporations Act 2001* or Div. 4 of Part 3 of the *Commonwealth Authorities and Companies Act 1997*.[37]

Arguably, if the tests outlined above are applied in practice, then such conflicts are being managed according to the law and consistently with the APRA prudential standard. There is therefore an argument that these heightened obligations in relation to the management of conflicts and the duty of priority, which must be satisfied by trustee boards and individual directors, are sufficiently robust to allow trustee boards to fulfil their fiduciary duties despite the presence of directors who serve on the board of more than one APRA-regulated superannuation fund. That is, the enhanced trustee duties with respect to conflicts management and the duty of priority provide for adequate accountability and render any proposed ban on multiple trusteeships redundant.

That being said, there is a counter-argument that has been raised by a number of ASFA members that, despite the heightened obligations that have been imposed on trustee board and directors as a result of these new legislative provisions and the prudential standards in relation to the management of conflicts and the duty of priority, the potential conflicts of interest or duty arising from individuals serving on more than one APRA-regulated superannuation trustee board cannot be sufficiently overcome. In particular, it has been argued by a number of ASFA members and external industry stakeholders that:

1. An individual who is on the trustee board of more than one superannuation fund cannot properly fulfil their fiduciary duties to both funds simultaneously.
2. The presence of that individual on multiple trustee boards would likely compromise discussion at board level to some extent. That is, their presence would impact on other board members' ability or willingness to discuss issues which may be commercially sensitive or involving proprietary information.
3. Notwithstanding the fact that multiple trustee board memberships do occur at present, the negative perception that arises as result of such conflicts is unacceptable. This negative perception is not just limited to the funds in question. It has the potential to detrimentally impact the reputation of the entire industry, particularly the public's perception of the industry's governance practices.

As such, there is an argument that, with the exception of closed defined benefit corporate funds, an individual should not be allowed to be a trustee or director on more than one APRA-regulated superannuation fund trustee board.

It should be noted that the Coalition have stated that they "would ensure that directors who want to sit on multiple superannuation boards must demonstrate to APRA that they do not have any foreseeable conflicts of interest".[38]

[37] Refer section 52(4) of the SIS Act.

[38] Adjournment Speech in the Senate, "Certainty & Stability in Superannuation under the Coalition", given by Mathias Cormann on 6 February 2013.

Consultation questions:

10.2 Can the potential conflicts of interest and duty caused by multiple trusteeships of superannuation funds be managed as required under the conflicts covenants in the SIS Act (section 52(2)(d) and 52A(2)(d)) and the Prudential Standard?

10.3 Are there any circumstances in which an individual serving on multiple trustee boards of APRA-regulated superannuation funds would not give rise to a potential conflict of interest and duty?

10.4 Do you believe that individuals should be allowed to serve as a director of more than one APRA-regulated superannuation fund trustee board? Please provide the basis for your response.

10.5 If a ban on multiple trusteeships was to be introduced, what challenges would this present to the industry or to business models currently in place?

10.6 For funds that have (or have experienced) multiple trustee board memberships, how have any actual or potential conflicts of interest or conflicts of duty been resolved? It would be useful if you can provide specific examples in your response if possible.

10.3 Related party dealings

Another common situation is that a trustee/board member is associated with a service provider that is, or could be, used by the fund. The question in this situation is whether the actual or potential conflict of interest can adequately be managed.

Where related party dealings are permitted, the nature and severity of the conflict can vary greatly depending on the situation. Trustee boards must be able to properly understand and monitor whether the related service provider is adequately providing the services it has been contracted to provide. Trustee boards should be regularly monitoring the performance of their service providers, including those of related party service providers, as part of their outsourcing policy.[39]

The *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* – inserted a new section 58B into the SIS Act which reads as follows:

"58B Service providers and investments

(1) This section applies if a trustee, or the trustees, of a regulated superannuation fund does one or more of the following:

(a) acquires a service from an entity;

(b) invests assets of the fund in or through an entity;

(c) invests assets of the fund in or through a financial product;

(d) purchases a financial product using assets of the fund;

(e) uses assets of the fund to make payments in relation to a financial product.

[39] Refer to Prudential Standards SPS 231 Outsourcing for requirements relating to performance under outsourcing agreements.

(2) If the trustee, or the trustees, would not breach:

(a) a provision of any of the following:

(i) this or any other Act;

(ii) a legislative instrument made under this or any other Act;

(iii) the prudential standards;

(iv) the operating standards;

(v) the governing rules of the fund; or

(b) any covenant referred to in this Part or prescribed under this Part;

in doing one or more of the things mentioned in subsection (1), the general law relating to conflict of interest does not apply to the extent that it would prohibit the trustee, or the trustees, from doing the thing."

The supplementary explanatory memorandum comments on section 58B as follows:

> "The amendments insert a new section 58B into the SIS Act which will make it clear that, provided a trustee complies with all relevant Acts, legislative instruments, prudential and operational standards, governing rules and statutory covenants, the trustee may enter into service provider and investment arrangements (and undertake the preliminary dealings necessary to do so) even though this might otherwise breach the general law conflict of interest prohibitions. It will not be necessary, therefore, for the trust deed to expressly authorise the trustee to engage in dealings with the related party. The words 'general law relating to conflict of interest' are intended to be construed broadly so as to cover general law relating to both trustees and directors and to cover conflicts between duties to beneficiaries and the interest of beneficiaries, on the one hand, and duties to other persons and the interests of other persons, on the other. [Amendment 8]"[40]

Where related party dealings are permitted, the dealings need to be on a commercial, arm's length basis. Consideration could be given to creating an obligation to disclose the details of any such dealings to members in the fund's annual report.

Consultation questions:

10.7 Do the current legislative and regulatory requirements adequately address the risks, to the fund and its members, that arise as a result of trustee boards entering into arrangements with related parties? Is further tightening of, or prescription around, the requirements needed?

10.8 What challenges, if any, do trustee boards face in complying with the requirement to regularly monitor the performance specifically of related party service providers?

10.9 Should there be an obligation to disclose the details of any related party dealings to members in the fund's annual report?

[40] Clause 1.3, supplementary explanatory memorandum to *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013.*

11 Environmental, Social and Governance factors

Many factors that fall under the Environmental, Social and Governance (ESG) umbrella can influence investment performance over both short and long term timeframes. For investors - in particular superannuation funds with long term investment horizons - there is a strong incentive to ensure that underlying investment processes are aligned with their investment horizons. Some examples of prominent factors that fall under the umbrella of ESG are given in Table 1.

Table 1 – Some examples of prominent ESG factors

Environmental	Social	Governance
Pollution/emissions	Workplace health & safety	Board structure
Energy use	Human capital	Executive remuneration
Water use	Intellectual capital	Dealings with associates
Waste management	Demographic trends	Disclosure

The United Nations Principles of Responsible Investment (UN PRI) was developed in 2006 in response to the growing worldwide concern about ESG issues which can affect the performance of investment portfolios.

At the time of preparing this paper, there were approximately 27 superannuation funds that had signed up to the UN PRI principles. It is likely that more funds will continue to sign up to the UN PRI principles in the future. At this time, the commitment required of signatories is not overly prescriptive or onerous – essentially they commit to consider and incorporate ESG issues into their investment processes (including seeking disclosures on ESG issues from entities in which they invest) and to promote acceptance and implementation of the UN PRI principles across the broader financial community.

Unlike ethical investing or socially responsible investing (SRI), the integration of ESG practices into traditional investment processes does not use values-based screening techniques. It is about the implementation of an investment process that includes thorough analysis and ongoing management of all relevant investment factors, including those of an ESG nature. The primary objective of ESG integration is to improve the risk adjusted returns achieved from investment portfolios.[41]

Whilst ASFA supports the ultimate aims of the UN PRI, ASFA does not support directed investments – i.e. mandated directions to invest or dis-invest in certain classes of assets. The adoption of the UN PRI or a similar set of principles should be a decision left to each trustee board, to be considered in the context of managing the fund to maximise members' benefits. It should not be mandatory.

This view was supported by the Super System Review (Cooper Review) Panel in their report released in July 2010 which stated that "[t]he Panel considers that superannuation investment is long term and that trustees of superannuation funds, perhaps more than any other type of investors, are well placed to take advantage of long-term opportunities. Accordingly, they should consider ESG risks appropriately.

[41] ASFA Discussion Paper: Integration of Environmental, Social and Corporate Governance (ESG) Factors into Investment Processes for Trustees (April 2010).

However, the Panel does not believe that the Principles for Responsible Investment, or similar, should be prescribed."[42]

The report went on to say that "[i]n developing investment strategies, trustees should explicitly consider both short and long term risks, consistent with their stated investment horizon. Trustees would not be required to make decisions based on ESG issues but as ESG issues represent one type of long term risk, trustees should consider ESG issues as they think appropriate".

There is no legal obligation at present for funds to consider ESG issues as part of their broader consideration of investment/risk management issues. However, ASFA highly recommends that trustee boards consider ESG issues as part of their broader consideration of investment/risk management issues when exercising their duty to formulate and give effect to appropriate investment strategies under section 52 of the SIS Act.

Consultation questions:

11.1 Do you support the proposition that trustee boards should consider ESG issues as part of their broader consideration of investment/risk management issues? Please provide the basis for your response.

11.2 Should trustee boards be required to consider ESG factors as part of their broader consideration of investment/risk management issues (i.e. should this be a mandatory consideration)?

11.3 What benefits exist in superannuation funds signing up to the UN PRI principles?

[42] Super System Review Final Report – Chapter 6: Integrity of the system (July 2010)

12 Proxy voting

Proxy voting rights are a valuable tool for investors and are intrinsically linked to the expression of their views on corporate governance practices. They play an important role for investors in terms of affecting the corporate governance performance of the companies in which they invest.

The largest class of institutional investor in Australia is superannuation funds. For medium-sized and large superannuation funds, exposure to Australian equities normally includes direct investment in shares as well as indirect investment through managed investment schemes that themselves hold shares. With billions invested in equities, shareholder voting is a key economic right and an opportunity for superannuation funds to shape the governance practices of the companies in which they invest.

Commonly, the task of managing a superannuation fund's direct investments in shares will be delegated to an investment manager. Where the trustee employs a professional investment manager and the investment management contract includes a typical voting clause, then:

- the obligation to consider whether to vote rests with the investment manager; and
- the trustee has a duty to monitor and supervise the investment manager's exercise of its discretion in regard to voting.

Trustees of superannuation and other fiduciaries who rely on professional investment managers should take a close interest in their managers' performance on proxy voting.

ASFA is supportive of the new sub-regulations 2.38(2)(n) and (o) of the SIS Regulations, inserted by the *Superannuation Legislation Amendment (MySuper Measures) Regulation 2013*. These provisions require trustee boards to publish their fund's proxy voting policies as well as a summary of when and how they have exercised their voting rights in the previous financial year in relation to shares in listed companies.[43]

Whilst the sub-regulations were intended to commence from 1 July 2013, ASIC Class Order relief [CO 13/830] exempts trustee boards from complying with the requirement to make this information publicly available on the fund's website, and to keep it up to date at all times, until 31 October 2013. In addition, we note that the former Treasurer, Chris Bowen, indicated that the then Labor Government would support ASIC providing a further extension of time – potentially until 31 December 2013 – for trustees to comply with this requirement. It is likely that this extension would be supported by the Coalition following the change of Government.

Consultation questions:

12.1 How easy/difficult will it be for funds to obtain details of how proxy votes have been exercised from investment managers in a timely manner (particularly with respect to voting rights exercised before the obligation to publish commenced)?

12.2 Are there any (other) challenges faced by trustee boards with respect to complying with the requirement to publish the fund's voting policies and details of voting rights exercised?

12.3 What additional guidance, if any, is needed from ASIC to assist trustee boards to comply with this requirement?

[43] SIS Regulation 2.38 was intended to start on 1 July 2013 but has been deferred by Class Order until 31 October 2013. There is also a possibility of a further extension until 31 December 2013.

Appendix – Summary of consultation questions

We would appreciate feedback from ASFA members on the consultation questions outlined below, or any other comments you might have, on the various governance-related issues addressed in this paper. For those interested in more of the detail, including some background and discussion on the various issues, references to the relevant sections within this discussion paper are provided.

Topic	Consultation Questions	Section
Independent directors	*3.1 Do you believe that trustee boards should consider the appointment of a number of independent/non-aligned board members, subject to appropriate changes being made to the SIS Act (as per question 3.2 below)? If so, what is an appropriate/ideal number?* *3.2 Should the SIS Act be amended to allow trustee boards that comply with the equal representation rules to appoint more than one independent board member?* *3.3 What is your view of the proposition that, rather than enforcing structural tests of independence, in order to improve governance greater focus should be placed on the skills/experience of board members, the quality of interaction between board members and overall decision-making process of the board?* *3.4 What benefits and/or challenges do you believe the appointment of multiple independent board members would bring to superannuation funds (or specific industry sectors)?* *3.5 What is your view regarding the appropriateness or otherwise of the Coalition's position that at least one-third of the directors on superannuation boards should be independent?* *3.6 What other independence issues currently exist and how can these be addressed?*	3.1
Definition of independence	*3.7 Do you support the proposed (more comprehensive) definition of 'independence' provided in section 3.2 as one that is better suited to the needs of the superannuation industry in the post-Stronger Super reform world? Or do you believe the SIS legislation definitions of "independent director" and "independent trustee" adequately deal with this?* *3.8 Do you agree with the proposed removal from the definition of the requirement for an individual not to be a member of the fund in order to be considered independent? Please provide the basis for your response.*	3.2
Role of the Chair	*4.1 Should trustee boards be required (through the prudential standards or elsewhere) to document the duties of the Chair and establish appropriate appointment procedures, including a mechanism for succession planning? Or is this better addressed in the prudential guidance?* *4.2 Do you support the proposition that the roles of the Chair and Chief Executive Officer should not be exercised by the same individual? If so, does this requirement need to be enshrined in legislation or stipulated in the prudential standards?*	4

	4.3	*Do you support the proposition that the Chair should have the ability to vote and have a casting vote if necessary (i.e. an extra vote to break a deadlock on an issue)?*	
Size of trustee boards	*5.1* *5.2* *5.3* *5.4*	*Do you support the position that trustee boards need the flexibility to be able to create a structure that is the most effective for their fund and, as such, need discretion as to the size of their trustee board? Please provide the basis for your response.* *If you do not support this position, what should be the upper (and lower) limit on the number of directors a superannuation trustee should be allowed to have?* *In your view, what is the preferred/ideal number (or range) of board members for a superannuation fund?* *Where a merger of funds occurs, resulting in inflated board numbers in the merged fund, would it be appropriate to require the merged fund's board to set a target number of directors and a target date for achieving that number?*	5.1
Characteristics of effective boards	*5.5* *5.6* *5.7*	*In addition to investments, are there any other areas in which trustee boards should collectively have a sufficient level of expertise or prior experience (superannuation knowledge, finance/business, legal, audit/risk/compliance, insurance etc)?* *What challenges, if any, do trustee boards face in identifying and assessing the competencies of their board members, both individually and as a collective?* *Where gaps are identified in the skills or expertise of directors, what challenges do trustee boards face in rectifying these gaps (through training, upskilling etc) in a timely manner? What other rectification strategies/activities have proven effective?*	5.2
Gender diversity	*6.1* *6.2* *6.3* *6.4* *6.5*	*Should trustee boards have to conduct an objective assessment of their composition, including gender diversity, and set medium-to-long term goals with respect to female representation? Should a broader definition of diversity be considered by trustee boards (i.e. in addition gender diversity)?* *Do you believe 40 per cent female representation on trustee boards is an appropriate/achievable target for the superannuation industry? If so, what is an appropriate timeframe that funds should set to achieve such a target? If not, what is an appropriate/achievable target in your view?* *What impediments currently exist, if any, that would prevent a fund (or the industry in general) from achieving such a target? How can such impediments be overcome?* *For funds with equal representation, whose members are predominantly male or female, would a requirement to set and disclose a target on female representation pose any significant challenges for the fund or its members?* *Should trustee boards be compelled to disclose to their members how they are tracking against their target on female board representation and, if they have no women directors, disclose why this is the case? If so, what is the best way to disclose this information to members (method, frequency etc)?*	6

	6.6	*If you believe that setting an industry-wide goal of achieving greater female representation on trustee boards is appropriate, how can such a goal be realised?*	
Performance and competency	7.1	*Other than as a result of being a disqualified person or failing the fit and proper test, from a good governance perspective are there other factors that trustee boards should consider in determining whether to remove non-performing directors (eg. unresolved conflicts, lack of engagement due to time constraints, non-contribution, overly dominating, ongoing health issues or any other reasons)?*	7
	7.2	*Is greater prescription required to specify the various factors that should be considered by trustee boards in assessing performance/underperformance of individual directors? If so, what should these factors include (and what exceptions should be put in place with respect to these factors)?*	
	7.3	*Should the SIS Act and Regulations be amended to remove the requirement that independent or member-representative directors generally can only be removed in the same manner they were appointed?*	
	7.4	*What challenges, if any, do trustee boards face in being able to remove non-performing directors? How can these challenges be overcome?*	
	7.5	*How can/do trustee boards deal with any areas of dysfunction in order to improve the competency/performance of individual directors and/or the overall functioning of the board?*	
Remuneration Policy	8.1	*Notwithstanding the fact that the obligation to maintain a documented Remuneration Policy approved by the trustee board is already a requirement under SPS 510, what challenges, if any, do trustee boards face in addressing all of the relevant arrangements (eg. performance-based remuneration and its alignment with prudent risk-taking, fixed/variable components, sources of remuneration etc) within their Remuneration Policy?*	8.1
	8.2	*What other challenges, if any, do trustee boards face in terms of complying with this requirement?*	
	8.3	*Is three years an optimal period of time in which to review the trustee board's Remuneration Policy or could such a review, in your opinion, be adequately undertaken more/less frequently?*	
Disclosure of remuneration	8.4	*What challenges, if any, exist in trustee boards having to disclose on the fund's website both the nature and amount of remuneration paid to trustee directors?*	8.2
	8.5	*Does the fact that this disclosure needs to cover both cash and non-cash benefits and show amounts paid to trustee directors by the fund as well as amounts paid by others for services to the fund pose any significant difficulties?*	
	8.6	*The regulations require a trustee board to disclose, for each executive officer, the percentage of the bonus or grant for the financial year that was forfeited because the person did not meet the service and performance criteria. Does the disclosure of such potentially sensitive information pose a challenge for funds (particularly as there are a multitude of different reasons why a*	

		bonus might not have been paid, but these will not be apparent from the disclosure)?	
	8.7	*The list of remuneration items to be disclosed is extensive. It includes short term employee benefits such as salary, fees (eg. director fees), bonuses and profit sharing, post-employment benefits such as pensions and superannuation benefits, other long-term employee benefits, signing on bonuses and share based payments. Are these remuneration items sufficiently clear or do some elements need to be defined/clarified? Would the provision of examples be of assistance?*	
Tenure	*9.1*	*Do you agree with the advantages and disadvantages of setting maximum tenure periods that have been listed? Are there any other advantages or disadvantages that you believe exist which have not been listed?*	9
	9.2	*Do you support the view that the advantages of setting a maximum tenure on boards (i.e. regular infusion of fresh ideas and perspectives etc) outweigh any disadvantages? If so, what is an appropriate period? If not, why not?*	
	9.3	*In your view, would the introduction of maximum tenure requirements result in experienced trustee directors being lost to the industry? Or would it result, to some extent, in experienced trustee directors moving from one fund's trustee board to another at the end of their tenure?*	
	9.4	*Would setting fixed renewable terms (eg. 3-year renewable terms subject to a maximum of 3 or 4 terms) be a practical way for a fund to implement a maximum tenure period? If not, how else could such an outcome be achieved?*	
	9.5	*Are there any implications around a trustee board having to specify the circumstances where it may step outside the terms of its tenure policy?*	
	9.6	*Would you support a requirement that would limit the ability of directors to serve on boards based on a maximum age? That is, is age an appropriate measure/proxy for an individual's capability to serve as a trustee director or a suitable indicator that a director has been on a board for a sufficiently long period of time? If so, what would be an appropriate age limit in your view?*	
	9.7	*Alternatively, are there any other factors (other than age or health issues) that could serve as an appropriate measure/proxy for an individual's ability to serve as a trustee director? Or do you believe that a person's ability to serve as a trustee director should be measured solely on their performance and their ongoing capacity to perform their duties as trustee director?*	
Conflicts of interest	*10.1*	*Are there any additional legislative or prudential requirements that can/should be introduced, over and above the current obligations under sections 52 and 52A of the SIS Act, SIS Regulation 2.38(2)(m) and SPS 521, that potentially could enhance the way in which trustee boards manage actual or potential conflicts? That is, are there any gaps or ambiguities in the current legislative and prudential requirements on conflicts that require further discussion?*	10.1

Multiple trustee board membership	*10.2*	*Can the potential conflicts of interest and duty caused by multiple trusteeships of superannuation funds be managed as required under the conflicts covenants in the SIS Act (section 52(2)(d) and 52A(2)(d)) and the Prudential Standard?*	10.2
	10.3	*Are there any circumstances in which an individual serving on multiple trustee boards of APRA-regulated superannuation funds would not give rise to a potential conflict of interest and duty?*	
	10.4	*Do you believe that individuals should be allowed to serve as a director of more than one APRA-regulated superannuation fund trustee board? Please provide the basis for your response.*	
	10.5	*If a ban on multiple trusteeships were to be introduced, what challenges would this present to the industry or to business models currently in place?*	
	10.6	*For funds that have (or have experienced) multiple trustee board memberships, how have any actual or potential conflicts of interest or conflicts of duty been resolved? It would be useful if you can provide specific examples in your response if possible.*	
Related party dealings	*10.7*	*Do the current legislative and regulatory requirements adequately address the risks, to the fund and its members, that arise as a result of trustee boards entering into arrangements with related parties? Is further tightening of, or prescription around, the requirements needed?*	10.3
	10.8	*What challenges, if any, do trustee boards face in complying with the requirement to regularly monitor the performance of related party service providers?*	
	10.9	*Should there be an obligation to disclose the details of any related party dealings to members in the fund's annual report?*	
Environmental, Social and Governance (ESG) factors	*11.1*	*Do you support the proposition that trustee boards should consider ESG issues as part of their broader consideration of investment/risk management issues? Please provide the basis for your response.*	11
	11.2	*Should trustee boards be required to consider ESG factors as part of their broader consideration of investment/risk management issues (i.e. should this be a mandatory consideration)?*	
	11.3	*What benefits exist in superannuation funds signing up to the UN PRI principles?*	
Proxy voting	*12.1*	*How easy/difficult will it be for funds to obtain details of how proxy votes have been exercised from investment managers in a timely manner (particularly with respect to voting rights exercised before the obligation to publish commenced)?*	12
	12.2	*Are there any (other) challenges faced by trustee boards with respect to complying with the requirement to publish the fund's voting policies and details of voting rights exercised?*	
	12.3	*What additional guidance, if any, is needed from ASIC to assist trustee boards to comply with this requirement?*	