

File Name: 2015/29

23 October 2015

Mr Pat Brennan
General Manager, Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Email: superannuation.policy@apra.gov.au

Dear Mr Brennan

**Governance arrangements for RSE licensees:
Prudential Standards SPS 510 and SPS 512
Draft Prudential Practice Guides SPG 510 and SPG 512**

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission to the Australian Prudential Regulation Authority (APRA) regarding draft Prudential Standard SPS 510 Governance (SPS 510), draft Prudential Practice Guide SPG 510 Governance (SPG 510), draft Prudential Standard SPS 512 Governance Transition (SPS 512) and draft Prudential Practice Guide SPG 512 Governance Transition (SPG 512), all of which were released with APRA's discussion paper "Governance arrangements for RSE licensees" on 31 August 2015.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 14 million Australians with superannuation.

General comments

As an overall comment, ASFA is broadly comfortable with the amendments to draft SPS 510 and SPG 510 on the basis that they facilitate and provide guidance to RSE licensees on the Government's reforms to superannuation governance arrangements, which require all RSE licensee boards to have a minimum of one-third independent directors, including an independent chair.

ASFA is also broadly comfortable with the contents of draft SPS 512 and SPG 512, which specifically relate to the transition by RSE licensees to the new governance arrangements.

However, there are some matters with respect to which we wish to provide comment. We have some general comments as well as feedback on specific areas of the Prudential Standards and the Prudential Practice Guides. These are discussed in the attached appendices.

Our comments in this submission are based on the proposed changes set out in the *Superannuation Legislation Amendment (Trustee Governance) Bill 2015*, which is currently before Parliament, and assumes that the proposals will be passed in their current form. Once the legislation is passed, ASFA would welcome the opportunity to provide further comment at that time, particularly if any changes are made to the legislation that would have an impact on the prudential framework.

Thank you for providing us with the opportunity to make this submission and to participate in the consultation process.

If you have any queries or comments regarding the contents of our submission, please contact ASFA's Senior Policy Adviser, Jon Echevarria, on (02) 8079 0859 or by email jechevarria@superannuation.asn.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Glen McCrea', is positioned below the 'Yours sincerely' text.

Glen McCrea
Chief Policy Officer

Appendix 1 – Comments regarding SPS 510 Governance

(i) *Governance framework*

ASFA supports the inclusion of new paragraphs 16 – 18 in SPS 510, which set out the requirements for RSE licensees to establish and be ultimately responsible for a governance framework that includes, at a minimum:

- a formal charter that sets out the roles, responsibilities and objectives of the Board;
- the Board’s policy on the size and composition of the Board and any Board committees;
- the Board’s renewal policy;
- the Board’s policy on the nomination, appointment and removal of directors;
- the Board’s voting rights and procedures;
- the Board’s policy on director tenure, including maximum tenure periods;
- policies and processes used by the RSE licensee to manage risks relating to fitness and propriety of responsible persons;
- policies and processes of the RSE licensee relating to the management of conflicts of interest; and
- a review process to ensure that the governance framework remains effective.

(ii) *Board performance and independence assessment*

Paragraph 23 of SPS 510 has been amended to include the requirement for the Board to annually assess the independence of individual directors.

ASFA is broadly supportive of this amendment. However, given the expanded intent and application of this paragraph, we recommend that the heading preceding this paragraph be amended to “Board assessment of performance and independence”.

Also, in our submission to the Senate Economics Legislation Committee dated 14 October 2015, we recommended that section 87(1)(d) of the *Superannuation Legislation Amendment (Trustee Governance) Bill 2015* needs be amended in order to bring the legislation in line with the stated policy intent that the mere fact of being a director on the trustee board does not result in the individual being deemed to have a material business relationship that would preclude them from being considered ‘independent’.

Our support for the annual test for independence is contingent on the legislation being so amended. Without this legislative clarity, independent directors would potentially fail the annual independence assessment purely by virtue of having served as a director (and thereby had a material business relationship with the trustee board) in the past three years.

We also note FAQ 2 recently released by APRA in relation to the requirement for RSE licensees to assess the independence of directors who are, or have in the past three years been, directors or executive officers of large employer-sponsors, and believe that APRA’s expectations in this area should be reflected in SPS 510 and SPG 510.

(iii) Board nomination, appointment and removal

ASFA supports the addition of new paragraph 25 into SPS 510 regarding the requirement to establish and implement policies and processes for the nomination, appointment and removal of directors. We are broadly comfortable with the items that must be included in these policies and processes as outlined in sub-paragraphs (a) to (i).

The manner in which directors are appointed to trustee boards is critical to ensuring good governance and the effective operation of the trustee board. ASFA's view is that every trustee director should be nominated and appointed through a formal and transparent process based on competency. The individual should meet certain minimum standards set by the trustee board prior to being appointed, and the trustee board should be actively involved in the nomination/appointment process to ensure that the new director has the relevant experience and skill set required by the board.

In addition, ASFA supports the requirement for RSE licensees to have policies and processes in place that deal with the length of the directors' terms as well as the maximum number of terms that can be served.

This could be done by setting maximum fixed renewable terms. For example, a common approach in listed corporate boards is to have a four-year term with an optional additional four-year term, with a maximum of two terms, but directors could serve again after a given period of time off the board. Another approach is to have multiples of 3-year terms up to a maximum of, say, three or four terms.

Such arrangements could be supported by a comprehensive succession planning process, including staggering the end of director's terms in order to avoid a major loss of experienced directors from the board all at once.

Consistent with ASFA's previous submissions, including our submission to Treasury on 12 February 2014 on its discussion paper – "Better regulation and governance, enhanced transparency and improved competition in superannuation", ASFA considers that an appropriate maximum appointment term for trustee directors would fall somewhere in the range of 9 to 12 years.

(iv) Board committees

Paragraphs 43 and 53 respectively state that at least one-third of the members of the Board Remuneration Committee (BRC) and Board Audit Committee (BAC) must be independent. In addition, paragraphs 42 and 52 state that the chairperson of the BRC and the BAC must be an independent director of the RSE licensee.

We reiterate our position, as articulated in our submission to APRA dated 31 July 2015, that ASFA does not support the prudential requirement that the BAC and BRC must have a minimum of one-third independent directors. In ASFA's view, while it is reasonable to require at least one independent director to be appointed to the BAC and BRC, beyond this, it should be up to each RSE licensee to decide how best to structure their committees.

Also, ASFA does not support the requirement that the chair of the BAC and BRC must be an independent director. In our view, these committees should be chaired by the director who is most suited to that role, regardless of whether or not they are an independent director.

Appendix 2 – Comments regarding SPG 510 Governance

(i) *Size of trustee boards*

ASFA supports the guidance provided in paragraph 5 that it would be prudent practice for RSE licensees to periodically review the total number directors on the Board and assess whether its size supports the effective functioning and decision-making of the Board.

However, the guidance in this paragraph goes on to say that:

“Whilst the size of the Board is ultimately a matter for the RSE licensee to set in light of the size, business mix and complexity of their business operations, APRA’s view is that it is difficult to envisage circumstances in which an RSE licensee would need a Board of more than 12 directors”.

ASFA endorses the need for RSE licensees to have boards of manageable size in order to ensure that they operate effectively. In our view the optimal board size is somewhere between 6 and 12 directors.

However, we also recognise 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.

Trustees 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.

It should be noted that there are a number of the factors that can contribute to large boards, including:

- 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; and
- as a consequence of the new governance requirements to appoint a minimum of one-third independent directors, which could result in larger boards (at least in the short term) as new independent directors are appointed.

ASFA considers that the language used in paragraph 5 expressing APRA’s view on the size of boards is unnecessarily rigid and, in our view, should be amended to acknowledge that funds need flexibility in this regard, and that there may be certain circumstances in which it would be appropriate for RSE licensees to have more than 12 directors.

In particular, the wording expressed in paragraph 5 of SPG 510 seems to be at odds with the contents of Helen Rowell’s speech to the AIST Governance Ideas Exchange Forum on 20 October 2015, which maintained that, beyond complying with the requirement to have a minimum of one-third independent directors, trustees would have the flexibility to determine the size of their board. There was no indication in Ms Rowell’s speech of an APRA expectation that trustees should be constrained to having 12 or fewer directors. On the contrary, her speech focused on trustee boards having flexibility in relation to their desired size and composition, which ASFA fully supports.

(ii) Dedicated nomination committee

ASFA supports the view that it would be prudent practice for trustee boards to consider using relevant board committees to provide oversight of key governance matters, which could include a dedicated nomination committee.

We agree with the possible responsibilities of a dedicated nomination committee as outlined in sub-paragraphs 9(a) and (b). However, sub-paragraph (c) states that the responsibilities of a dedicated nomination committee might include overseeing remuneration and performance assessment policies and processes.

In our view, this would appear to be more in line with the responsibilities of the Board Remuneration Committee, as outlined in paragraph 45 of SPS 510, which states that “[t]he responsibilities of the Board Remuneration Committee must include... an assessment of the Remuneration Policy’s effectiveness and compliance with the requirements of [SPS 510]”.

We suggest that sub-paragraph 9(c) be deleted from SPG 510 or amended to:

“(c) ensuring succession plans are in place to maintain an appropriate balance of skills, experience and expertise on the board.”

(iii) Reappointment of existing directors

ASFA recommends that the guidance in sub-paragraph 27(a) be amended to include the additional wording below (underlined).

“(a) in the case of an existing director being reappointed to the Board as an independent director, the length of the director’s tenure on the RSE licensee’s Board, including whether the director’s reappointment adheres to the Board’s policy on director tenure.”

(iv) Suggestions on minor wording changes

The word “assess” at the beginning of sub-paragraph 27(c) should be deleted.

Also, we suggest that paragraph 33 should be amended to include the additional wording below (underlined).

“33. ... APRA expects an RSE licensee would take into account the requirement in SPS 510 to have a minimum of one third independent directors on the Board Remuneration Committee and the Board Audit Committee...”

Appendix 3 – Comments regarding SPS 512 Governance Transition

(i) Transition plan

ASFA supports the amended two-stage transition process, which requires only the high level preliminary assessment to be undertaken by 1 July 2016 (with the full transition plan to be prepared and submitted to APRA by 1 January 2017).

In our submission to APRA dated 1 July 2015, following APRA’s letter to all RSE licensees on 26 June 2015 regarding the regulator’s proposed changes to the governance prudential framework, ASFA recommended that RSE licensees be given an additional six months (that is, until 31 December 2016) to prepare their transition plan and have it approved by their board.

We are appreciative of the fact that APRA has extended the timeframe for preparing the full transition plan by six months. We believe this additional timeframe will give RSE licensees sufficient time to fully consider and implement these significant changes in the most effective manner possible with minimum upheaval for funds and their members.

(ii) Preliminary assessment / reclassification of existing directors

The prudential guidance (specifically paragraph 16 of SPG 512) makes it clear that the new governance requirements do not preclude an existing director from being reclassified as an independent director where they meet the relevant requirements, regardless of their previous status or role on the Board.

ASFA suggests that it would also be worth including a statement to this effect in the transition prudential standard (SPS 512), as part of the RSE licensee’s preliminary assessment process.

Paragraph 7 could be amended to include the additional wording below (underlined).

- “7. A transitioning RSE licensee must, as part of its preliminary assessment, consider:
- ...
- (b) whether each existing director, including the chairperson of the Board, is independent within the meaning in [proposed section 87 of the SIS Act], including the basis for any reclassification of an existing director”

Appendix 4 – Comments regarding SPG 512 Governance Transition

(i) Board committees

Paragraph 28 of SPG 512 states that “APRA does not expect RSE licensees to appoint independent directors to board committees until the RSE licensee has complied with the requirement in [proposed section 86 of the SIS Act] to have a minimum of one-third independent directors on the Board”.

ASFA supports this statement, particularly as there will be situations where an RSE licensee applies to APRA for a determination that a director is independent. Until a determination from the regulator is received, it may be difficult for the RSE licensee to make a decision on the final make-up of their BAC and BRC with a view to complying with the requirement that these committees consist of a minimum of one-third independent directors.

That being said, as stated previously, ASFA does not support the minimum one-third independence requirement for these board committees.

(ii) Exit plan (ceasing RSE licensees)

Paragraph 29 of SPG 512 states that “APRA expects that the process to wind-up an RSE licensee’s business operations would ordinarily take no longer than 18 months to complete. Where an RSE licensee’s exit plan indicates a timeframe longer than 18 months, APRA expects the plan would provide a detailed explanation of why the additional timeframe is necessary”.

ASFA support this statement. However, we believe that SPG 512 should be updated to reflect the commentary in FAQ 4 of APRA’s recently-released FAQs on the governance consultation package. Specifically, it would be helpful to include a new paragraph 31 that states:

“Where an RSE licensee can demonstrate that, despite its best endeavours, it is unable to cease operating by the end of the transition period, the RSE licensee can apply to APRA for an extension to the transition period to enable a further period within which the RSE licensee will cease operating. APRA will review such circumstances on a case-by-case basis, and exercise its powers when there are compelling reasons to do so. RSE licensees are encouraged to liaise with APRA throughout the transition period and advise APRA as soon as it has become apparent that it may not cease operating by the end of the transition period.”