

EXPLANATORY GUIDE

Superannuation Legislation Amendment (Governance) Bill 2015

Background

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) establishes the governance rules and supervision arrangements that apply to the different types of prescribed superannuation funds. Under Part 9 of the SIS Act, boards of RSE licensees (or groups of individual trustees) acting as trustees of standard employer-sponsored superannuation funds of five or more members must consist of equal numbers of employer representatives and member representatives. There can also be an additional independent director if such an appointment is permitted under a fund's governing rules and is requested by the employer or member representatives on the board.

Under section 31 of the SIS Act, the *Superannuation Industry (Supervision) Regulations 1994* (the SIS Regulations) can prescribe operating standards relating to 'the number of trustees, and the composition of boards or committees of trustees, of funds'.

A longstanding feature of the superannuation governance framework is the requirement for some superannuation trustee boards to have equal representation (typically standard employer-sponsored funds¹). This reflects the position adopted with the commencement of occupational superannuation, that members should have a greater voice through representation on non - public offer funds (industry, corporate and public sector). Equal representation allowed both stakeholder groups (employers and employees) to have oversight and responsibility for funds' operations.

The Super System Review (the Cooper Review) examined the equal representation model and found that although it was an important part of the governance structure twenty years ago, 'changes in the industry over time and certain implementation practices mean that equal representation no longer seems to achieve its original ... objective' (Cooper Review, p.53). In addition, the Review articulated the issue around governance in superannuation:

'Trustee governance structures have not kept up with developments in the industry. There have also been difficulties for trustees and their trustee-directors in understanding what is expected of them and, as the industry consolidates, conflicts of interest and conflicts of duty arise regularly. Good trustee governance is fundamental to enhancing members' retirement incomes' (Cooper Review, p.43).

The Cooper Review recommended that the SIS Act be amended so that it is no longer mandatory for standard employer-sponsored funds to maintain equal representation in selecting their directors. In

¹ Not-for-profit funds include industry, corporate and public sector funds. These funds are generally affiliated with either the public sector, individual corporations, trade unions or employer representatives and have an equal number of employer and employee representatives on a trustee board. Retail funds are generally run for profit and are affiliated with banks or other financial institutions. Retail funds have significantly more choice investment options than non-retail funds. In general terms, equal representation means that the board of a corporate trustee must consist of equal numbers of employer representatives and member representatives.

addition, the Cooper Review noted that the presence of independent directors on boards is best practice in corporate governance (Cooper Review, p.55).

The Government's amendments to ensure there is appropriate provision of independent directors on superannuation trustee boards are consistent with the Cooper Review recommendations and views expressed in the Financial System Inquiry Final Report (FSI Report) such as that "given the diversity of fund membership, it is more important for directors to be independent, skilled and accountable than representative" (FSI Report, p.135).

In addition, there is currently an inconsistency in the governance frameworks (including self-governing guidelines) on the number of independent directors on retail and not-for-profit superannuation fund boards and the definitions of independence. Relevantly, the current definition of "independent director" under the SIS Act is designed to achieve independence from stakeholders (i.e. employers and members and their representative organisations) rather than independence from management, service providers and advisers.

Equal representation is enshrined in the SIS Act.² Under the SIS Act, funds operating under the equal representation model are only able to appoint one independent director, however in practice funds have the ability to apply to APRA to appoint more than one independent director.

Not for profit funds and corporate funds typically operate under equal representation arrangements. By contrast, retail funds (including Financial Services Council (FSC) member entities) have no restrictions in appointing independent directors and from 1 July 2014 are required, under FSC's self-governing standard, to have a majority of independent directors and an independent chair.

Therefore an objective of setting a minimum standard in terms of the number of independent directors on all superannuation trustee boards is to promote good governance by broadening each board's pool of experience and expertise. In addition, independent directors allow for an increased accountability of decisions made by other directors who may have conflicting interests. (FSI Report, p.134)

Summary of new law

The Superannuation Legislation Amendment (Governance) Bill (the Bill) amends the SIS Act to improve governance in superannuation by ensuring that there is an appropriate proportion of independent directors on trustee boards for all APRA-regulated superannuation funds.

Superannuation funds regulated by APRA are operated under trustee arrangements. Under this framework, a corporate trustee overseen by a number of individual directors, or a group of individual trustees, is responsible for managing a superannuation fund's assets on behalf of the fund's members and beneficiaries. The trustee is known as a registrable superannuation entity (RSE) licensee as it operates under an RSE licence issued by APRA.

The Bill provides that all boards of RSE licensees acting as trustees of APRA regulated superannuation funds, including standard employer-sponsored superannuation funds, are required to have a minimum of one-third independent directors and an independent chair on their boards. Where the licensee is a group of individual trustees, one-third of these individuals must be independent.

² At June 2013, 68 per cent (103 of 151) of registrable superannuation entity (RSE) licensees had an equal representation board structure.

The Bill provides a definition of 'independent'. It includes among others persons who are not substantial shareholders of the RSE licensee or do not have or have not had within the last three years a material relationship with the licensee, including through their employer. In addition, APRA may make prudential standards setting out further requirements a person must meet in order to be independent. APRA also has powers to determine that a person is, or is not, independent.

The new governance rules will not apply to self-managed superannuation funds. They will also not apply to a fund that has an acting trustee appointed under section 134 of Part 17 of the SIS Act.

The new governance regime will apply from 1 July 2016. Where an APRA regulated superannuation fund is established after 1 July 2016, the RSE licensee of that fund will have to adhere to the new governance arrangements from the time it is established. Similarly, RSE licensees authorised on or after 1 July 2016 will have to comply with the new regime. APRA regulated funds and RSE licensees established or authorised before 1 July 2016 will have three years to transition to the new arrangements from the time the legislation is passed.

The Bill provides that APRA may make prudential standards setting out in detail how these funds and RSE licensees are required to transition to the new governance regime.

The current equal representation rules for standard employer-sponsored superannuation funds in Part 9 of the SIS Act will be repealed after that time to allow these funds to comply with the new regime.

RSE licensees acting as trustees of all APRA regulated superannuation funds will be required to publicly report (on an 'if not, why not' basis) in the annual report whether they have a majority of independent directors commencing 1 July 2019 (this requirement will be implemented through changes to the reporting requirements in the *Corporations Regulations 2001* (the Corporations Regulations)).

RSE licensees that notify APRA that they will cease operating before the end of the transition period will not be required to comply with the new governance regime.

Detailed explanation of new law

Part 1 – Main amendments

Existing Part 9 of the SIS Act is repealed and a new 'Part 9 – Governance arrangements for regulated superannuation funds' is substituted.

New section 86 of Part 9 requires trustees of registrable superannuation entities that are regulated superannuation funds to have at least one third independent directors and an independent chair. In the case of a group of individual trustees at least one third of the trustees must be independent. The independent chair may be counted towards the minimum one third independent director requirement. The appointment and removal of independent directors must comply with any relevant prudential standards made by APRA.

New subsection 87(1) sets out the definition of *independent* applied in the Bill. It says that a person is independent if they do not have a substantial holding in the licensee or a related entity; are not directly associated with a person who has such a substantial holding; do not have a material relationship with the licensee, including through their employer; and have not in the last 3 years been an executive officer or director of a body that has a material relationship with the licensee.

In addition, the person must also meet the requirements in any relevant prudential standards (subsection 87(2)). The standards may also set out the meaning of *material relationship* and other key terms used in the definition of *independent* (subsection 87(4)). As part of the circumstances giving rise to a material relationship, the standards may specify which body corporates (as mentioned in paragraph 87(1)(c)) are included in the scope of the definition. Examples of such bodies could include parent companies, standard employer sponsors and bodies with the right to nominate potential directors. Finally, subsection 87(3) allows APRA to make determinations as to whether a person is independent or not.

New section 88 allows APRA to make a determination that a person is independent if it is reasonably satisfied that the person is likely to be able to exercise independent judgment in their role as a director. APRA is able to do so on application by the RSE licensee or on its own initiative (subsection 88(2)). It must give written notice of any such determination, or of the reasons for refusing an application for a determination (subsection 88(3)). Any such determination takes effect on the day it is made, and ceases to have effect if APRA makes a determination under new section 90 that the person is not independent (subsection 88(4)).

New section 89 requires APRA, when it receives an application for a determination under new section 88, to do so within 60 days, extendable by a further period of 60 days, provided the extension is made within the initial 60 day period. APRA may request additional information from the RSE licensee (subsection 89(2)). In that case, the initial 60 day period only starts when APRA receives the information requested (paragraph 89(3)(b)). A failure by APRA to make a decision is equivalent to a refusal of the application (subsection 89(6)).

New section 90 allows APRA to determine that a person is not independent if it is satisfied that the person is unlikely to be able to exercise independent judgment as a director. Any such determination takes effect on the day it is made, and ceases to have effect if APRA makes a determination under new section 88 that the person is independent (subsection 90(3) and paragraph 90(4)(b)). APRA may specify in a determination that it only has effect for a particular period. In such a case, the determination ceases to have effect when that period ends, unless APRA before that time makes a determination under new section 88 that the person is independent (paragraph 90(4)(a)).

New section 91 allows boards a period of 90 days to replace an independent director in case of a vacancy.

New section 92 allows APRA to issue a direction to an RSE licensee to comply with Part 9, together with a statement giving its reasons for issuing the direction (subsections 92(1) and (2)). A failure to comply with such a direction without a reasonable excuse is a strict liability offence with a penalty of 100 units (subsections 92(4) and (5)). APRA may withdraw such a direction if it is satisfied that the RSE licensee is in compliance with Part 9 (subsection 92(3)).

New section 93 states that breaching a provision of Part 9 is not an offence, other than as set out in subsection 92(4). However, any contravention may result in a direction from APRA not to accept any contributions made by an employer-sponsor under section 63 of the SIS Act.

New section 94 states that Part 9 does not apply in circumstances where an acting trustee has been appointed under Part 17 of the SIS Act.

New section 95 provides that the requirements set out in Part 9 override any contradictory provisions in trust deeds and other rules governing a regulated superannuation fund.

Consequential amendments

Part 2 – Other amendments

The entry in the table in section 4 of the SIS Act relating to Part 9 is updated to reflect its new contents relating to governance arrangements for regulated superannuation funds.

The following definitions in existing section 10 of the SIS Act that are related to the current equal representation regime are removed:

- employer representative
- independent director
- independent trustee
- member representative
- policy committee

A new definition of ‘independent’ is inserted in section 10, referring the reader to new sections 87, 88 and 90 in Part 9 of the SIS Act.

In the definition of ‘reviewable decision’ in section 10, existing paragraphs (m) to (nc) are removed. These are decisions made under the former equal representation regime which is being repealed. Two new reviewable decisions are substituted, being a decision by APRA refusing to make a determination under new section 88 that a person is independent, and a decision under new section 90 that a person is not independent.

Subsection 10(2) of the SIS Act is repealed. This subsection relates to the definition of ‘independent director’ in the context of the equal representation rules.

The notes in section 29C of the SIS Act are amended to refer to the new requirements in Part 9 to have at least one third independent directors.

Subsection 29EA(4) is repealed. This subsection clarifies that APRA may, under subsection 29EA(1) of the SIS Act, impose the additional licence condition that the RSE licensee must ensure that a fund, or class of funds, specified in the condition must comply with the alternative agreed representation rules whenever section 92 of the SIS Act (which is being repealed) applies to the fund.

Subsection 63(6) dealing with contraventions of Part 9 of the SIS Act is amended to take account of the new regime in that Part. The heading and the contents of the subsection now refer to the new independence requirements imposed on trustees and directors, and not to equal representation rules.

Subsections 63(7B), (7C) and (7D) of the SIS Act dealing with breaches of the former equal representation rules are repealed.

Section 107 of the SIS Act is repealed. This section applies duties to the trustees of employer sponsored funds to establish procedures for appointing member representatives when those trustees are required by law to have member representatives.

Section 108 is repealed. Subsection 108(1) provides that, where a standard employer sponsored fund relies on subsection 89(2) (which is being repealed) to comply with the equal representation

provisions, then the additional duties in subsection 108(2) apply to trustees of the fund. Subsections 108(3) and (4) are the attached offence provisions.

Section 117 of the SIS Act sets out circumstances in which amounts may be paid out of an employer-sponsored fund to an employer-sponsor. A number of changes are required to reflect the removal of the equal representation rules in Part 9 of the SIS Act, as follows:

- Sub-subparagraphs 117(5)(b)(i)(B) and 117(5)(b)(ii)(B) are removed. They set out a requirement that a resolution must be passed by equal numbers of employer and member representatives on boards of trustees or among groups of individual trustees. Subparagraphs 117(5)(b)(i) and (ii) are amended to take account of this removal.
- Subsection 117(9) is repealed as it makes provision for situations where additional independent trustees or directors have been appointed to equal representation trustee groups or boards.

Paragraphs 223A(1)(f) and (g) relating to breaches of repealed sections 107 and 108 are repealed.

Subparagraph 312(1)(a)(iv) of the SIS Act is repealed. It incorporates an 'absence of a quorum at a meeting of members of a policy committee' in the definition of procedural irregularity, relating to provisions under former Part 9 that are being repealed in this Bill.

Paragraph 327(1)(d) of the SIS Act is repealed. It provides that subsections 63(7B), (7C) and (7D) of the SIS Act are 'modifiable provisions' as defined in the Act. However, these three subsections are being repealed in this Bill.

Application and transitional provisions

Part 3 – Application provisions

The Bill defines the ***transition period*** applying to these amendments as starting on 1 July 2016 and ending on the third anniversary of the day on which the Bill receives the Royal Assent following its passage by Parliament.

Existing RSE licensees are not required to comply with the new provisions in Part 9 of the SIS Act requiring at least one third independent directors and an independent chair during the transition period provided they comply with any transitional arrangements prescribed by APRA in prudential standards made for that purpose. With respect to any matters not covered in the prudential standards, licensees that are a standard employer-sponsored fund must continue to comply with the requirements in the former Part 9 of the SIS Act, including the equal representation rules.

New RSE licensees and regulated superannuation funds established after 1 July 2016 will have to comply with the new Part 9 requirements from that date.

If a licensee notifies APRA that it will cease operating before the end of the transition period then it does not have to comply with any of the requirements relating to having at least one third independent directors and an independent chair. However, if such a licensee continues to operate after that time then the new requirements will be taken to have applied to it from 1 July 2016.

Superannuation Legislation Amendment (Governance) Regulation 2015

Corporations Regulations 2001 and Superannuation Industry (Supervision) Regulations 1994

Summary

Amendments to the *Corporations Regulations 2001* (Corporations Regulations) will require RSE licensees acting as trustees of all APRA regulated superannuation funds to report (on an 'if not, why not' basis) in the annual report whether they have a majority of independent directors commencing 1 July 2019.

A number of consequential amendments are made to the Corporations Regulations and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations).

Detailed explanation: Corporations Regulations

The definition of **policy committee** is removed from subregulation 1.0.02(1) of the Corporations Regulations, as the concept of policy committees is being removed from the SIS Act.

A number of amendments are made to regulation 7.9.37 of the Corporations Regulations which sets out information that must be included in fund annual reports.

- A clause in paragraph 7.9.37(1)(b) is removed as it refers to subsection 92(10) of the SIS Act which does not exist.
- A minor editorial amendment is made at the end of subparagraph 7.9.37(1)(b)(i).
- A sub-subparagraph relating to policy committees is removed from paragraph 7.9.37(1)(c), and the paragraph is restructured to take account of the amendment.
- Amendments are made inserting new paragraphs 7.9.37(1)(ca) and (cb) in regulation 7.9.37. Paragraph 7.9.37(1)(ca) provides that, if the trustee is a body corporate, the annual report must state whether a majority of the directors are independent and if not, why that is the case. Paragraph 7.9.37(1)(cb) sets out a similar requirement where the trustee is a group of individual trustees.
- Subregulation 7.9.37(5) is amended to include a number of important definitions, including those of **independent** and **RSE licensee**. These words have the same meaning as in the SIS Act.

Item 11.1 in Schedule 10A of the Corporations Regulations is amended to remove inserted subsection 8C from section 1017C of the *Corporations Act 2001*. This subsection makes a provision relating to the applicability of certain charges to persons acting on behalf of policy committees which will no longer exist under the new governance regime.

Detailed explanation: SIS Regulations

Subregulation 2.05(3), which deals with certain matters relating to policy committees, is repealed. Policy committees will not be required once the new governance regime is in force.

Paragraph 3.04A(a) is repealed, as it relates to the equal representation rules in the SIS Act which are being removed. Regulations 3.05 to 3.09 are repealed because they deal with policy committees which

will no longer exist under the new governance regime. Regulation 3.04A is restructured as regulation 3.05 to take account of these amendments, without any further changes to its contents.

Regulations 4.06, 4.07 and 4.08 are repealed. They depend on sections 107 and 108 of the SIS Act, which themselves are being repealed.

Sub-subparagraph 13.16(2)(a)(ii)(B) is repealed, as it depends on section 89 of the SIS Act which is being repealed. Sub-subparagraph (A) is restructured to take account of the removal of sub-subparagraph (B), without any further changes to its contents. Subregulation 13.16(5) is repealed as it depends on sub-subparagraph 13.16(2)(a)(ii)(B).