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Governance requirements for RSE licensees: proposed amendments

I refer to your letter to all RSE licensees dated 26 June 2015 regarding the above.

The Queensland Local Government Superannuation Board (the Board) as trustee for the Local Government Superannuation Scheme (LGsuper) welcomes the opportunity to provide feedback and comments on the proposed amendments to the governance requirements.

LGsuper

The Board is constituted under the Local Government Act 2009 (Qld) to act as trustee for LGsuper, a public sector superannuation fund. LGsuper provides coverage for all employees in Queensland local government and comprises 84,000 members and approx. \$9.3b in FUM.

The Board currently comprises 3 member-elected representative directors, 3 employer representative directors and 3 independent directors, previously approved by APRA. The Chair of the Fund, Bronwyn Morris, is an independent director. This structure has been in place since 1 July 2014. The new structure was designed to bring greater balance, leadership and diversity as the Board broadens its combined skills, knowledge and experience.

Comments on the Proposed Amendments to the Governance Requirements

As has been quoted in the press, the Board supports the Government's proposals to introduce a requirement for a minimum of one third of a board of an RSE licensee to be independent directors. The Board of LGsuper meets this requirement and has benefited from the broader range of skills and expertise which the three independent directors have brought to the organisation. The appointments have made what has been a good Board, better.

However, our Board is concerned that the draft legislation and the proposals being put forward by APRA, by implication, under-value the skills and experience of member and employer representative directors. Many of these directors have made valuable contributions over many years and gained significant Board experience. Further, because by definition they are closer to the members and employers, they have a more direct understanding of those parties' interests and needs than most independent directors.

- **3 Year Waiting Period under Proposed Section 87(1)**

The Board notes that under the proposed Section 87(1) *Meaning of independent from an RSE licensee*, any person who has had any time in the last 3 years a material relationship with the RSE licensee cannot meet the definition of independent director.

The LGsuper Board has appointed three independent directors to its board and all three had previous employment or board positions with service providers to LGsuper. These previous relationships have been subject to a standing conflict declaration which will expire 3 years after the termination of their employment or board position with the service provider. The three independent directors have brought new skills and experiences to the LGsuper Board.

Two of the 3 existing independent directors were well known to the Board before their appointment. This knowledge/relationship was an aid to the Board in appointing them as, due to the prior relationship, they were more certain of the fit of the persons with the Board's culture and thus any risk of the Board becoming less effective following the appointments was minimised. Further, the Board was well aware of their skills and knowledge and how they complemented the existing skills on the Board.

While the existing independent directors will have met the definition by the end of the transition period, in future if the proposed legislation is passed the Board will not be able to make such worthy appointments for at least 3 years following the end of the material relationship with the Board. The requirement could deny the Board some excellent candidates, and, their skills and industry knowledge may lessen during the waiting period.

The Board considers that the requirement should be established on an "if not, why not" basis for persons who previously worked for service providers to the RSE licensee. The licensee would then have to justify in their annual report why they selected such persons and how they would improve the performance of the RSE licensee.

The Board notes that the definition under Section 87(1) also covers previous employees of the RSE licensee or its related entities. The Board supports the retention of the 3 year waiting period for such persons as separation of periods of service as staff of funds and directors of funds is generally accepted as good governance practice.

The Board has referred these comments to Treasury as feedback on the draft legislation for the governance changes.

- **Definition of "material relationship"**

In its proposals to RSE licensees, APRA sets out some of the circumstances which will constitute a 'material relationship'. APRA proposes to include material professional advisors, consultants or suppliers. While this clarifies the types of relationships which may be covered, the concept of 'material' is unclear.

For example, is an investment manager managing 5% of a fund's investments in a material relationship? Is a law firm which is one of a panel of lawyers in a material relationship? Is a consultant who performs an adhoc service to the RSE licensee in a material relationship?

It would appear that APRA has not attempted to define 'materiality' in this context and as such it should be left up to the RSE licensee to determine what is a material relationship and to justify their rating to APRA if queried.

- **Multiple directorships**

APRA has indicated that its revisions to SPS 510 will address a number of areas of good practice and, in particular, mentions multiple directorships (of RSE licensees). The LGsuper Board supports the allowance of multiple directorships due to the currency of knowledge and experience of these directors which is believed will benefit the boards of the relevant funds.

It is considered that the allowance should be subject to consideration by the RSE licensees as to obvious conflicts of duties and interests such as competitor funds. It is considered that there would be a number of funds in Australia where there was little if any competitive tension and multiple directorships with those funds would be beneficial to the funds and the industry as a whole. For example, a director on the LGsuper Board would not be considered to have any significant conflict if he or she also held a directorship on the board of a fund in Tasmania.

The conflicts management frameworks for RSE licensees should already cover the possibility of conflicts of interests and duties of candidates for director positions. As such they should cover the consideration of any conflicts for candidates already holding positions on other RSE licensee boards.

- **Independent v non-executive directors**

It is noted that APRA will require a majority of independent directors on audit committees and remuneration committees. Given independent directors will normally be recruited with specialist skills (for example, investments) then they may carry a very heavy workload if they are required to participate on multiple committees, particularly committees for which their skill-set is limited. It seems likely that Committee members may need to be recruited from outside the Board to enable the independence requirements to be met.

Given representative directors, or non-independent directors, are normally non-executive positions it seems reasonable to us that they should be able to fill a number of positions on remuneration and audit committees. As indicated earlier in this submission, many non-independent directors have considerable board and committee experience and are cognisant with governance requirements to act with impartiality. The LGsuper Board requests that APRA mandates that the audit and remuneration committees should comprise non-executive directors only, not necessarily a majority of independent directors.

- **Parent Company independent directors**

APRA's proposals for the definition of independence include an intention to align the requirements with those in CPS 510 (applicable to ADI's) which state:

"... independent directors on the Board of the parent company or its other subsidiaries may also sit as independent directors on the Board of the institution."

The LGsuper Board is concerned with the mis-alignment of interests where this will apply to super funds, particularly retail funds, operated by financial institutions which receive revenues for managing the funds. RSE licensees are required to operate their funds in the best interests of all members. Directors on the board of a parent company are aligned to the interests of its shareholders. The LGsuper Board challenges how such persons could be construed as independent directors on the board of an RSE licensee if they are appointed to that board by the parent company with a revenue-making expectation of the RSE. There seems to us to be a very real conflict of interest with such appointees and as a result they should not be categorised as independent directors on the board of related RSE licensees.

The Board generally supports the proposed legislation and changes to the prescribed requirements to improve the governance of superannuation funds. The Board considers that the prescribed requirements should retain sufficient flexibility to enable RSE licensees to appoint the persons they consider are the best candidates for independent director positions on their boards and thus minimise the risk of reduced board effectiveness. The Board considers the above points are worthy of further consideration by APRA in determining the changes to the governance requirements.

Yours faithfully

A handwritten signature in black ink, appearing to read "J. Harde". The signature is written in a cursive style with a large initial "J" and a long horizontal stroke at the end.

for Bronwyn Morris
Chair