

CORPORATE SUPER ASSOCIATION

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The Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

FINANCIAL SERVICES INQUIRY FINAL REPORT

We refer to the Report issued on 7 December 2014 and to Treasury's call for written submissions prior to decision making by the Government.

The Corporate Superannuation Association

Established in 1997, the Corporate Superannuation Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors.

The Association represents a total of 25 funds controlling \$65 billion in member funds, held in a total of 695,396 individual accounts. In general, these funds are sponsored by corporate employers, with membership restricted to employees from the same holding company group, but we also include in our membership several multi-employer funds with similar employer involvement and focus.

Areas for comment by our Association

We wish to comment on the following areas:

- allocation of default funds; and
- independent trustees.

Default funds

Proposal for competitive tender

We support the "wait and see" approach in respect of the MySuper system and its effectiveness in providing appropriate competition and efficiency for fund members. We consider it would be precipitate to judge that the new environment has failed to produce the competitive environment that is hoped for. We agree that there are many forces in the

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Australian system that would raise queries about creating an environment that focused entirely on competition in fees.

We have grave doubts about the likely benefits of introducing a competitive tender for one or several default funds, and the Review acknowledges a major difficulty:

A potential downside of this option is less tailoring of life insurance policies and investment strategies to specific demographics of fund members; for example, if members work in the same industry. Some superannuation funds have been able to tailor insurance and other product features because of the homogeneous nature of their membership¹.

The above highlights a serious hazard of the proposal.

The existing arrangements, where corporate employer-sponsored funds have been retained in awards, preserve some very valuable arrangements for members, which are superior to what would be offered by a generic, minimum feature, minimum cost MySuper arrangement that would be likely to win a competitive bid as suggested. In many of our funds' MySuper funds which have been maintained as award default funds, there are insurance arrangements that:

- exceed the minimum requirements under MySuper; and
- take advantage of group negotiation to secure the following advantages:
 - coverage for certain individuals whose situation is difficult to cover in isolation,
 - coverage at lower cost, and
 - coverage in specific work forces and work situations where the risks are subject to specialised underwriting.

It would be very difficult to preserve these advantages in a situation where all new entrants defaulted to a basic plan.

In addition, if new entrants defaulted to a basic plan, there would be loss of mass and hence of viability for the existing arrangements, where new entrants contribute to the stability and viability of a group arrangement.

Treatment of corporate funds in default arrangements

On page 115 of the Report, it is suggested that existing corporate funds could be allowed to continue to receive new default fund members from new entrants to the work force, provided that the fund gives members comparable benefits to funds successful in the competitive process.

We support the exclusion of corporate MySuper funds from the competitive process, and their retention as default funds if their benefits are comparable with those successful in the competitive process.

It would be important, if this suggestion were adopted, for the criteria for "comparability" to be made very clear, and to permit existing favourable arrangements for employees to be retained without employer-sponsored funds being required to go through an expensive formal competitive process.

¹ Financial System Inquiry – Final Report, page 110.

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Governance – Independent Trustees

The Inquiry has recommended that Government:

Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements (Recommendation 13).

The Report recommends that an arm's length definition of independence should apply.²

However, the Report notes that:

In defined benefit schemes sponsored by a single employer, equal representation of employees and employers is appropriate and consistent with the governance models of defined benefit pension funds internationally. These funds would continue to operate using the structure for which equal representation was designed, with the employer bearing the financial risk from the board's decisions.

The equal representation model has less relevance in the current superannuation system, which predominantly consists of public offer DC funds and funds less focused on a single employer.

As more fund members exercise choice, directors appointed by employer and employee groups are less likely to represent the broader membership of public offer funds (see *Recommendation 12: Choice of fund*). Given the diversity of fund membership, it is more important for directors to be independent, skilled and accountable than representative.³

Employer-sponsored funds that include defined benefit divisions

We would like to clarify that the intention is to maintain the equal representation trustee model for funds other than public offer funds.

Many of our funds include defined benefit divisions and also include accumulation divisions sponsored by the same employer or group of employers. In these funds, the employer continues to take a strong interest, not only in the defined benefit division but also in the fund as a whole. In these funds, the historical nexus between superannuation and employer interest in employee welfare is maintained. The employer seeks out insurance arrangements that are appropriate to, and competitive in, the industry in which it operates, and often provide additional administrative support and higher levels of contributions.

We concur with the Report's views that in defined benefit schemes the employer is bearing the financial risk arising from the scheme's trustees' decisions. Further, as indicated above, we believe that in corporate employer-sponsored funds in general, the employer maintains an involvement and sense of responsibility such that employer representation remains appropriate.

In these employer-sponsored funds, the nexus with the employer and the members' employment also means that there is significant value in the involvement of member representatives on the board. The representation of the member group brings benefits as follows. The members understand the issues that are important to members; the members and employer representatives in concert can arrive at productive conclusions regarding

² Financial System Inquiry – Final Report, page 133.

³ Ibid, page 135.

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issues particularly relevant to the employer's work force; there are governance benefits in general, in involving the two groups, in co-operation, in running the fund.

Hence, we believe that there is much still to be gained from retaining the equal representation model for all funds where there is a close nexus between the fund and the employer. We advocate the retention of the equal representation model in non-public offer funds; at the least, in funds where there is close employer involvement and a membership restricted to employees of the same employer or, the same affiliated group.

Criteria for "independence"

We believe that the criteria will vary depending on the fund context, and the nature of the stakeholders in the funds. In a fund operated "for profit", the presence on the trustee board of individuals without a stake in the potential "profit" is important. In employer-sponsored corporate funds, the situation is very different, given that the stakeholders are the employer (as sponsor and to varying degree, at financial risk) and the employees (also potentially at financial risk, and in general interested in the governance of the fund).

Public offer funds

The current SIS Act definition of "independence" is framed in the context of equal representation rules, hence is designed to exclude the groups that are likely to be present as employer or employee representatives. A revised definition of "independence" becomes relevant in public offer funds. In this context, the exclusion of parties related to the operator becomes relevant.

Employer-sponsored funds

While not advocating that non-public offer funds be required to move beyond the equal representation model, we note that a number of our funds include an independent director on the board, in many cases acting as independent chair. As criteria for selection of these independent directors, however, our member funds have observed that the primary desirable attributes do not revolve around the required independence from the employer, employer bodies, employees or employee organisations.

Instead, there is a focus on skills required to supplement the existing skills on the Board. Specialist skills in the areas such as investment, and the usefulness of an external but informed and experienced view, are valued.

We therefore advocate very different criteria for selection of "independent" or "external" directors in employer-sponsored funds. We support the appointment of "external" directors based on attributes required by the Board to supplement existing talents.

For employer-sponsored funds, we support flexibility in determining the number of external directors, including the option to retain the existing equal representation model providing employer-appointed and member-elected directors only. We would support the retention of the existing definition of independent director for the purposes of the SIS Act's equal representation rules, with changes:

- amending the terminology from "independent" to "external" (or other term not to be confused with the term adopted in relation to independent directors of public offer funds); and
- permitting the appointment of the number of external directors approved by the Board.

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Trustee businesses operating as corporate fund trustees

A number of operators provide trustee services for corporate funds that maintain their identities either as separate funds or as sub-funds of an "umbrella" fund. In these funds with external trustee, the employer typically retains a strong interest and the members and employers remain actively engaged in the management of the fund through policy committees or similar structures. Where an active policy committee exists, we see a strong argument for such trustee arrangements to receive similar recognition to those applying to employer-sponsored funds that do not employ an external trustee.

Yours faithfully



Mark N Cerché

Chairman

Corporate Superannuation Association