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Manager

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Superannuation Unit

Financial System Division
The Treasury
1 Langton Crescent
PARKES ACT 2600

Dear Sir or Madam

**Submission to Treasury on Better regulation and governance,
enhanced transparency and improved competition in superannuation**

We welcome the opportunity to make a submission in response to your Discussion Paper. The regulation and governance of entities participating in the superannuation system are very important in ensuring that the system delivers on its promise of a dignified retirement for all Australians. Our submission addresses issues raised in Part 2 of the Discussion Paper.

Experience tells us that a great many elements combine to create a governance environment in which the right decisions are made at the right time. Cognitive independence is undoubtedly one of them. Imposing structural solutions (for instance requiring a certain percentage or number of independent directors) designed to embed independence would, on its face, promote that objective.

We do however question whether structural approaches to independence are enough to guarantee effective governance. Professors Wheeler and Davis both demonstrated this point in papers delivered at a workshop jointly hosted by Herbert Smith Freehills, the Centre for Law Markets and Regulation and Association of Superannuation Funds of Australia on 30 August 2013. (The papers appeared in volume 25(3) (October 2013) of the Australian Superannuation Law Bulletin.) Independence of mind and a focus on the best interests of members may be promoted by regulating the structure of trustee boards, but a much wider range of structural and behavioural influences are also important.

A Governance Committee

Superannuation entities are becoming increasingly complex institutions. They require an expanding set of specialist skills and ever greater resources at all levels. Recent legislative and regulatory initiatives compound this challenge. Herbert Smith Freehills advises a wide range of superannuation clients on matters relating to governance. One of the responses that we are increasingly recommending is that clients consider the establishment of a distinct Governance Committee.

The Governance Committee would be a permanent sub-Committee of the Board. It would have a formal Charter and be composed only of Board members. It would be chaired by an 'independent' or 'non-affiliated' director. It would have minutes and report formally to the Board on a periodic basis.

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What would it do? It would have ongoing responsibility for monitoring and managing governance issues, and preparing for the annual performance assessment required by APRA. For instance, although it would not make recommendations on issues such as Board appointments and remuneration, it would ensure that robust processes were in place (and in fact complied with) when such decisions were made. It would also liaise with the Investment Committee on investment governance issues in order to ensure that the trustee company observes the same governance standards internally that it imposes on the companies in which it invests.

The Rationale

Adding another Committee to the governance structure of a superannuation trustee is not something to be taken lightly. Committees are costly to administer properly and can add to the internal complexity of the decision-making process of an organisation.

There are several concrete benefits that outweigh these costs:

1. In our experience many Board meeting agendas are overly congested. Directors are struggling to assimilate the vast quantity and diversity of information with which they are presented and for which they are ultimately responsible, including, significantly, regulatory and compliance matters. This is particularly true of Boards that are responsible for a number of funds, especially if they are subject to other targeted regulatory regimes, or for a number of schemes within the same fund.
2. Governance design is a specialist area, with technologies and ideas developing at a fast pace both in Australia and overseas. It requires the accumulation of expertise. Having all directors keep abreast of emerging best practices in the area is inefficient, most especially in the time-pressured environment to which we have already alluded.
3. The continuity of involvement that is implicit in the formation of a Committee provides stability and institutional continuity, vitally important in governance matters. With APRA increasing its attention on Board renewal, institutional structures that promote the accretion and retention of institutional knowledge are increasingly important.
4. The appointment of a Chairperson and members to a Committee will focus accountability in a way that is likely to be productive of greater priority and hence engagement than can happen when responsibility is shared, and hence diffuse, across the entire Board.

Yet Another Committee?

In our experience most trustees already operate several Board Committees in addition to those required under the Prudential Standards. As we noted above, we are loath to suggest imposition of another one without regard for the particular circumstances of the entity in question. We anticipate that our recommendation could be accommodated in a variety of ways depending on the current governance structure of the trustee. There may for instance be an opportunity to tighten the focus of other Committees, such as the Risk, Audit or Investment Committees by placing the more purely governance aspects of their charters with a Governance Committee. Smaller funds in which resources are even more stretched than normal may even find it desirable to expand the charter of an existing Committee to accommodate expressly the issues that would otherwise be addressed by the charter of a Governance Committee.



The one alternative that does not appeal is for the Board to assume that it can attend to these 'meta-governance' issues itself, 'on the fly' and in between the other day-to-day deliberations of the Board. A structural response to the current and very real risk of cognitive overload makes sense. As many trustees are finding, a model in which the Board becomes the forum for receipt and consideration of reports compiled by specialist sub-groups of the Board is the only way to deal with the affairs of the fund prudently and professionally.

Concluding Comments

There are a great many issues raised by the Discussion Paper released on 28 November. Our proposal is narrowly focussed. It responds to the issues underlying Focus questions 5 – 9 but is crucially focussed on Focus question 10 and, by implication, Focus question 1. It reflects a belief that one of the virtues of the de-centralised nature of the superannuation system is that appropriately qualified and motivated individuals and firms are positioned to make decisions that are tailored to the local circumstances they encounter, and be held accountable for those decisions. Neither the government nor its regulators are as well positioned to make those decisions on an ongoing basis. Imposing a further set of detailed governance rules on trustees is certainly within the government's power, but we believe that overly prescriptive regulation runs the very real risk of calcifying the flexibility of the system to respond to the varying needs of members across the community.

We commend this proposal to you and would be happy to answer any questions you or your colleagues may have in respect of this proposal or indeed any matters relating to the Discussion Paper where our expertise may be relevant.

Yours sincerely

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