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AUSTRALIAN SUPERANNUATION UPDATE

INDEPENDENT DIRECTORS SUPERANNUATION GOVERNANCE BILL

On Wednesday, 16 September 2015, the government tabled legislation that, if passed, will impose, in the case of corporate trustees, a requirement that one third of directors be independent from the trustee with an independent chair.

APRA has also released draft prudential standards.

KEY PROVISIONS

The existing governance provisions in the Superannuation Industry (Supervision) Act (**SIS Act**) are to be largely replaced.

Proposed section 86 imposes the core requirement of at least one third of directors must be independent from the corporate trustee. It also requires the chair to be an independent director.

Director voting requirements will be left at large, as the equal employer and member directors provisions and two thirds voting requirement for employer sponsored funds are to be repealed without any replacement requirements.

WHAT IS INDEPENDENT

1 A person is independent in terms of proposed section 87 if they do not satisfy any of the following:

- (a) have a shareholding interest in the trustee of 5% or more;
- (b) have a shareholding interest of 5% or more in a related body corporate of the trustee;
- (c) have in the preceding three years been an executive officer (other than a director) or employee of the trustee or an executive officer or director of a related body corporate of the trustee;
- (d) have in the preceding three years had a business relationship with the trustee that was material to the person;
- (e) have in the preceding three years been a director or an executive officer of a person that has had a business relationship with the trustee that was material to the person or have been an

- employee of that person and is or was involved in the business relationship; or
- (f) have in the preceding three years been a director or an executive officer of:
 - (i) a large employer-sponsor; or
 - (ii) an organisation that represents the interests of employer-sponsors that has the right to appoint or nominate for appointment, directors of the trustee; or
 - (iii) an organisation representing the interests of members that has the right to appoint or nominate for appointment, directors of the trustee.

SHAREHOLDING INTEREST

It is necessary to go to the *Income Tax Assessment Act 1997* in section 175-95 to determine what a "shareholding interest" is.

A person has a shareholding interest if the person is the beneficial owner of the shares or an interest in shares. A person also has a shareholding interest where they have a shareholding interest in another company and the other company has a shareholding interest in the company. Thus it does not apply to all types of ownership interests in companies.

The provisions should be concerned with whom has the power to appoint directors rather than just percentage shareholdings. Nominee holdings are expressly excluded.

As this is only one of a number of tests, this may not matter, as to be independent, none of the association tests must be triggered.

MATERIAL BUSINESS RELATIONSHIPS

The business relationship must be material to the person.

This will be a question of fact.

EMPLOYER ASSOCIATIONS AND UNIONS

Executive officers and directors of organisations representing employer sponsors with the right to nominate directors will not meet the independence requirements.

It is not clear why being a director or executive officer of a large employer is sufficient, whether or not the employer has a right to appoint a director.

In the case of unions it is a question of how the provisions actually apply. Such bodies do not have directors. Such bodies are only registered under Industrial Relations legislation.

Those Union Officials who meet the Executive Officer criteria will be caught. The operation of the provisions in relation to unions is problematic as the nature of unions, depending where they are registered, can be problematic and the nature of their officers does not fit readily with the company concepts of executive officers.

The concept of director is not used in the *Fair Work (Registered Organisation) Act 2009*. It uses the concept of office and holder of an office – which are not the same thing.

It may be that the holder of the office meets the definition of "executive officer" in section 10(1) of the SIS Act (assuming the union is a body corporate).

The position of union officials may need to be considered on a case by case basis having regard to the rules of the union.

TIMING OF APPLICATION OF THE TEST

It is implicit that the test is applied at the time of appointment. Otherwise the office of director will on appointment trigger the material business relationship with the trustee in paragraph (d) of proposed section 87(1).

PRUDENTIAL STANDARDS

APRA proposes prudential standards to deal with unexpected outcomes.

As well Prudential Standard SP510 is to be substantially revised and expanded in its scope.

WHEN THE NEW RULES APPLY

Transition rules allows three years from commencement date of the legislation for trustees to adopt the new requirements.

APRA will be making transitional prudential standards.

OTHER REQUIREMENTS

In addition there will be a new disclosure requirement in draft Corporations Reg 7.9.37(1)(c) which requires in the annual reporting that if you do not have a majority of directors that are independent you report why not.

WHO APPOINTS

The provisions do not specify any requirements as to how a trustee must go about selecting independent directors. Thus it would be open for the shareholders to confer this power on themselves as a whole, or confer it on the board as a whole, divide it amongst classes of directors or divide it amongst classes as shareholders.

The voting requirements for appointing independent directors will need to be considered. By simple majority of appointors or some other majority of appointors.

Thus for example the right to appoint a specified number of independent directors could be conferred on each class of shareholder.

The key requirements are to ensure that the person meets the independence requirements.

The board will be responsible to ensure that whatever procedure is adopted by the company complies with the Statutory provisions and the Prudential requirements.

Where shareholders appoint, the board will need a procedure to ensure the appointment does not take effect unless and until the board is satisfied it meets the Statutory and Prudential requirements. The board also needs the power to act where a director ceases to satisfy the Statutory and Prudential requirements and the appointor does not take action as required. A board veto may be required.

This assumes there is no prudential standard specifying how to go about appointing independent directors. The approach in draft Prudential Standard 510 is in terms that the directors decide the appointment and leaves open whom nominates.

ISSUES TO ADDRESS

- Size of Board.
- Role of Chairman - now that equal representation will cease to be a legal requirement for employer-sponsored funds - should the Chairman have a casting vote?
- Who appoints the independent directors?
- What should be the criteria for selecting the independent directors.
- The role that each independent director can be expected to contribute to governance framework.

- Who assesses what criteria should apply?
- Who assesses whether the criteria is met for each appointment.
- Like all matters the Board is ultimately responsible.

DRAFT PRUDENTIAL STANDARD - ISSUES

The draft Prudential Standard underlying approach is that the Board appoints the independent directors. There is no requirement as to whom selects and nominates proposed appointees.

This is at odds with traditional company law that it is the owners that select and appoint directors. Directors do not appoint directors.

The Director's role under the SIS Act is to ensure the law is complied with - that there are processes in place to select and appoint and the Board reviews to be satisfied there is compliance. Thus, traditional company law is subject to this modification. The Directors will need the power to take appropriate actions where the shareholders fail to and there will not be compliance with the requirements or the appointors are not or are unable to take action in time.

The draft Prudential standards go beyond independence and expand the governance framework.

Tenure requirements including maximum tenure periods are to be expanded.

A majority of directors must be non-executive directors.

Annual board assessment will include assessment of independence.

Existing governance framework will need review and expansion.

Board composition:

- new policy required; and
- new criteria will need to be specified.

Board Committees - the Prudential Standard will impose independence obligations for the Remuneration and Audit Committees. The changes are so extensive that the delegation to all Committees will need to be reviewed, having regard to the legal consequences of delegation to Board Committees.

Management of the selection and nomination process - will need to be developed.

VACANCIES

New section 91 will require Independent director vacancies to be filled within 120 days, as compared with current 90 days in section 89. Breach of section 91 is not an offence. However, APRA can direct compliance (section 92) and also prohibit acceptance of employer sponsor contributions - section 93.

Failure to comply with an APRA direction to comply is an offence (section 92(4)).

TRANSITION

By 1 July 2016 the trustee must undertake a preliminary assessment (and notify APRA) of the scope of current arrangements compliance with the new rules. It must identify current independents and the key changes required.

By 1 July 2017 develop a transition plan that addresses the issues set out in the Prudential Standard.

TRANSITION ISSUES

The status of existing independent directors is unclear. There is no recognition of transition - all existing independent directors at the time the legislation commences to apply to them will by virtue of the independent directorship - trigger proposed section 87(1)(d) - material relationship with the trustee - the independent directorship!

CONCLUSION

The changes are so extensive, trustees will need to give consideration to review of the whole governance process. At the bare minimum selection appointment, voting and delegation must be reviewed and changed to comply. Just how the existing process should be modified or replaced will need careful consideration.

MORE INFORMATION

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