



**“Superannuation Board Governance: Search for a Super Model”
May 5th 2008, Sofitel, Melbourne**

Conference Overview and Outcomes

The activities, structure, and governance arrangements of Australian superannuation funds are continually evolving in response to growth and increasing sophistication of the industry, regulatory developments, and financial sector evolution. The conference provided an opportunity to take stock of current governance arrangements for super funds, and to consider how this might evolve (or need to evolve) to provide the best achievable outcomes for fund members. There is a very large and growing pool of retirement savings under management by super funds, making the importance of good governance, through its link to fund performance, an issue of significant social importance.

Over 170 attendees at this conference listened to leading practitioners, academics and regulators presenting the results of current research and their perspectives on this important issue. The conference was sponsored by Deloitte, Holding Redlich, KPMG, PricewaterhouseCoopers, Russell, the Victorian Funds Management Corporation, and the Victorian Government. Following the one day conference, a half day research workshop was held at which six working papers on aspects of superannuation fund governance were presented by researchers working in the area.

The program for the conference and the presentations are available on the AIST web site at <http://www.aist.asn.au/events/superannuation-fund-governance-conference/program-and-presentations.aspx>. The remainder of this report reviews some of the issues raised over the course of the conferences, and suggests some questions arising which warrant future research.

Super Funds of the Future

Governance arrangements involve structures, processes and people, and their optimal design needs to be considered within the context of the size, complexity and activities of the organization involved, as well as the legal and regulatory framework within which it operates. Australian industry funds are now generally multi-employer (often public offer) funds, offering a range of investment choice strategies to their members in defined contribution schemes, who have the option to switch between competing funds. Retirement phase products are becoming increasingly important, as are the opportunities for providing complementary financial services of value to members.

In their strategic planning, what evolutionary paths (eg as a single purpose retirement savings/pension focus versus more diversified activities) should superannuation fund trustees be contemplating for their institution? What can overseas experience and research tell us about the potential member benefits (and risks) of alternative strategies?

Leo deBever (VFMC) and Keith Ambatscheer (Rotman International Centre for Pension Management, University of Toronto) both argued that the minimum size for superannuation funds to maximize efficiency is several times the current size of the largest Australian funds. This enables a number of functions currently outsourced to be undertaken internally. Hard statistical evidence on the existence of economies of scale in pension fund management is however lacking, and the question exists of whether alternative models (such as outsourcing or collaboration) can achieve equivalent benefits without mergers. How trustees should strategically approach the question of considering merger options versus continued independent operations is an important issue.

How does size affect efficiency in pension fund management? Have mergers brought net benefits for members? Can outsourcing and/or collaboration offset diseconomies of small size? If large scale means internalization of currently outsourced activities, what are the implications for the desirable characteristics of Board expertise and composition and organizational structure? How should Boards approach merger considerations (such as choice of partner) and determine that decisions made will be in the best interest of members?

The Trustee Model?

A critical question raised was whether the “trustee” model of governance is capable of providing best performance governance, although current governance structures are perhaps not pure trustee models. The RSE licensing requirements mean that “board members” (the individuals ultimately responsible) are directors of a trustee company (rather than trustees per se), and super funds are subject to a range of legislation beyond trust law.

One aspect of this discussion focused around the question of whether it was still appropriate to have “enthusiastic laymen” as board members, or whether boards should comprise individuals with a range of specific technical expertise. On this, there were a range of dissenting views. Keith Ambatscheer, for example, argued for the latter, suggesting that having lay people as directors relying on outside experts for advice was not appropriate for large complex financial institutions. Scott Donald (Russell Investment Group) provided a contrary view, noting that the SIS legislation explicitly provided for a “prudent person” approach (rather than a prudent business, investment, or expert person), and suggesting that the variety of perspectives from a “lay” board may have benefits in decision making (relative to possible homogeneity of views arising from a professional board). He also suggested that the emphasis on common sense accompanied by delegating to experts, has not been shown to have systematic failings, relative to other

governance models. It was noted that Australian corporate boards have a large proportion of members with legal, accounting and finance qualifications.

Is the representative trustee model still appropriate and capable of delivering best performance as the industry and funds evolve in a more complex financial system with ongoing regulatory pressures? How do we test which governance models work best? How can we test trustee decision-making skills across a range of relevant dimensions where choices made can have significant impacts on member benefits? How might superannuation boards evolve in the future? What are the implications for the optimal organizational structure of superannuation funds arising from the evolution of the trustee model in Australia?

Superfunds v other organizations

A number of presenters highlighted the influence of the evolutionary process on current governance structures. Pamela Hanrahan (University of Melbourne) noted how the legal arrangements have changed over time, such that trustees are dealing with corporations law, financial services law and trust law – and that better integration of these is warranted.

What changes to the legal and regulatory framework would be beneficial in improving corporate governance in superannuation? Have past regulatory and legal changes affecting superannuation governance structures had their anticipated effects, and how would they perform if subject to cost-benefit analysis?

In particular, super funds are quite different to other institutions (both within Australia and vis a vis pension organizations overseas), raising the question of how applicable research on governance arrangements in other types of institutions is for Australian super fund governance.

What are the key differences between Australian industry superannuation funds and those overseas, and how may this affect the applicability of overseas research on corporate governance in pension funds to the Australian case?

Shey Newitt (KPMG) noted that a favoured model of corporate governance had evolved for listed Australian companies, in the form of the ASX Corporate Governance Principles which adopt an “if not why not” approach to compliance. This model emphasizes *inter alia* an important role for independent directors, separation of CEO and Chairman roles, specific roles for specialist Board subcommittees. Empirical evidence to support some of these claimed features of good governance structures for listed companies is surprisingly weak, and Newitt’s research suggests that company knowledge and strength of relationships (rather than form, process, specialist financial knowledge etc) are perceived as more relevant for good Board performance. It is not clear how directly these various

factors are applicable to the case of the not-for-profit trustee model of industry superannuation funds – an issue being pursued in further research.

Are the ASX Corporate Governance Principles applicable for superannuation entities? How applicable are the OECD April 2006 Pension Fund governance guidelines? Are the OECD and ASX approaches compatible? How do Australian super funds perform against the OECD guidelines?

Super Fund Performance

Mike Rafferty (University of Sydney) noted that research into pension fund performance has, at least, three dimensions. One dimension concerns the extent to which the system and institutional arrangements lead to desirable outcomes in terms of delivery of pensions. A second dimension relates to the economics and management of pension fund organizations, and how various arrangements affect the operational efficiency and strategic decisions of those organizations. A third dimension is that of investment performance. He briefly outlined the approach being taken in some new research to determine whether superannuation fund investment performance, measured on a risk-adjusted basis, is affected by governance characteristics.

This topic was taken up in part by Ross Jones (APRA) who presented the results of some research by APRA involving a survey of governance of 187 funds under their prudential supervision. He noted some significant differences between industry and retail (public offer) funds in the characteristics of board members, board decision making processes and activities. He also noted that over recent years, the average return on assets of retail funds was less than that of industry funds by 2-3 per cent p.a.

Can differences in investment returns between superannuation funds be attributed to different governance arrangements, or do they reflect other factors such as risk? What is the correct measure to use in making performance comparisons between superannuation funds? What specific governance related characteristics are the most important drivers of returns to members?

An alternative approach to considering governance performance, is to survey trustees and fund executives to elicit opinions on how well they believe their board performs against specific criteria. Tony Brain (Deloitte) presented the results of their work in this area. Since the introduction of RSE licensing in 2004, there is a general perception that attention paid to governance processes had increased, including greater director awareness and greater attention to risk management. But there is limited self assessment by Boards and relatively limited director training. Remuneration levels were believed to be inadequate for responsibilities, and there was little refreshing of Board membership. Increasing responsibilities and risks faced by trustees are relevant in this regard. Neil Cassidy (CEO, Tasplan) presented a case study of how Board members could face reputational risk arising from adverse publicity about superannuation operational and/or financial performance – arising from events outside their (or management's) control.

Is Board compensation relevant to performance? How should Board performance be assessed? What is the appropriate form of performance and remuneration reporting by Boards to their members?

Ethics and Conflicts

Peter Hay (KPMG) addressed the question of potential conflicts of interest for trustees. He noted that multiple superannuation fund board memberships, originally an advantage for knowledge transfer between non-competing, not-for-profit, funds, may now create conflicts of interest with funds competing for members. Whether other potential conflicts, or suggested remedies, differ significantly from those faced in other types of organisations is something of an open question. Anona Armstrong (Victoria University of Technology) discussed how different individual characteristics and attitudes of Board members can lead to different approaches towards achieving an ethical climate in an organization. These may range from an emphasis on specific rules regarding specific behaviors through to emphasis on independent behavior within a set of generally accepted codes and norms.

Board Culture

A number of presenters addressed the issue of how to describe the concept of board culture, what determines it, what is a “good” board culture, how to change board culture. Angela Elmslie (Trustee Director, HESTA, VicSuper, CARE Super, Vision Super) defined board culture as “the way we do things” and “shared values and norms”, which are reflected in structures and policies, and decision making practices and philosophy. “Good” culture, she argued, involved a singular focus on members’ best interests, as well as other commonly expected desirable features of boards (ethical, questioning, cooperative, learning etc). She considered whether board Culture was a result of nature versus nurture, arguing that the representative trustee system was a “natural” influence leading to mission driven behavior and a sense of trusteeship, power sharing and diversity.

How should “members’ best interests” be operationalized for board decision making given that decisions often cannot avoid involving cross subsidies between different types of members (young v old; high v low account balances)? Is the “representative trustee model” or the “not for profit objective” more relevant for determining board culture?

Board Skills and Processes

Many speakers noted that Boards were collections of individuals, and that Board processes and arrangements needed to ensure desirable dynamics and decision-making. The role of the Chairman in establishing an appropriate environment was seen as important. Leo deBever argued that people often focus on what was interesting rather than important, creating a risk where lay Boards devote excessive attention to decisions

which may be better delegated to expert management (investments, asset purchases, choice of fund managers) rather than focusing on key strategic issues. Anne-Marie Corboy (CEO, HESTA) emphasized the importance of a range of specific processes and practices including existence of a Board Charter, statements of expectations of directors and required professional development, suitable induction programs and board performance reviews. To these, Neil Cassidy added a list of policies addressing specific issues (including conflicts, human resources, IT, ethics, whistleblowing, etc) which Boards need to have in place (and adhere to).

What are the similarities and differences (and causes of these) in board policies of different superannuation funds? How can “best practice” policies be identified?

Member Role in Governance

Members of Australian superannuation funds (industry, retail, or corporate) generally have a very limited role in their governance. Trustees are appointed by fund sponsors – in the case of industry funds by employer and union bodies. With the introduction of member choice of fund, members can express their opinion on the performance of a fund by “exit”, but have little scope for exerting effective influence by “voice”. There is a wide range of practices in terms of communicating governance practices and performance to members.

What is the optimal method of selection of trustees to superannuation funds? What information should Boards provide to members regarding Board performance and remuneration?

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