Superannuation fund governance: Trustee policies and practices

Executive Summary

Since 2002, APRA has undertaken considerable research and statistical analysis in the superannuation industry. This work is facilitated by APRA's role as the national statistical agency for the Australian financial sector. APRA has comprehensive statistical collections in superannuation extending back to 1995.

APRA has a prudential responsibility to administer the provisions of the *Superannuation Industry (Supervision) Act 1993* and associated regulations. Since 30 June 2006, all trustees of APRA-regulated superannuation entities are licensed. Licensees are encouraged to have appropriate risk management systems and risk management plans for funds under their trusteeship.

In June 2007, APRA published a special edition of *Insight*, containing 10 years of superannuation data (1996-2006). APRA classifies superannuation into four major types or sectors: Corporate, Public Sector, Industry and Retail. The first three are described as 'not for profit' funds while Retail funds offer superannuation to the public on a commercial basis. One of the features of the published statistics was the systematic difference in investment returns between the four sectors over the ten-year period.

Under the auspices of the Council of Financial Regulators (a body composed of the Reserve Bank of Australia, the Australian Securities and Investments Commission, APRA and the Treasury), APRA has undertaken further research including the reasons for the differing performance between fund types. Two surveys were involved. The findings of the first survey, which examines superannuation fund governance, are reported in this article. A second survey seeks to disaggregate fund returns into constituent elements comprising asset allocation, investment performance and expenses. The findings of this survey will be published at a later time.

The governance survey found that in many areas of trustee policies and practices, there was little difference between sectors. In other areas there were statistically significant differences. Some of the most important findings of the survey include:

a) Whilst there are few explicit policy requirements for the qualification, experience and training of trustee directors, in practice trustee directors of the large funds in the survey are typically well qualified, experienced and reasonably well trained in their trustee duties. APRA considers this outcome to satisfy 'fit and proper' rules in this area, which avoid prescription in favour of trustee judgement. By and large this approach seems to be working well. There are some differences by trustee type, but all superannuation sectors in general seem to be successful in selecting experienced and qualified trustee directors.

b) Superannuation is typically an enterprise employing substantial outsourcing. Most trustees outsource many aspects of fund operations and, as a group, they report reasonably good practice in managing these outsourced arrangements. This finding is supported by trustee licensing and the results of APRA's supervisory activities, which in most cases demonstrate that trustees are doing a satisfactory job in managing their outsourcing risks.

c) In many areas, there are statistically significant differences in policies and practices between trustees in the four sectors. Retail trustee practice is more often different from those of the trustees in other sectors.

d) Broadly speaking, Retail trustee boards seem to act more like the boards of shareholder-owned corporations, whereas trustees of other sectors tend to act more like traditional mutual superannuation trustees. Relative to the other trustees, Retail trustees have fewer directors, shorter (but just as frequent) board meetings, and rely more on fund executives to take the initiative on most key decisions. By contrast, trustees in the other three sectors mostly make the decisions with the main input coming either from themselves or from their consultants.

e) More than half of all Retail trustee directors are employed by related parties or by the fund itself, and very few are nominated by fund members. By contrast, many Industry, Corporate, and Public Sector trustee directors are member-nominated. This is an inevitable difference flowing from the structure and the equal representation provisions associated with directors in 'not for profit' funds. As a group, Retail trustee directors are paid considerably more for their trustee services than trustee directors in the other sectors.

f) More than half of Corporate, Public Sector, and Industry trustee directors are themselves members of their funds and, where they are members, they hold more than seventy per cent of their total superannuation assets in the fund. About one in five Retail trustee directors are members of their funds, typically for less than sixty per cent of their total superannuation assets.

Introduction

Superannuation is a cornerstone of the national economic strategy for funding the needs of Australians in retirement. Over the past decade, superannuation assets have quadrupled to over $1.1 trillion and this growth is expected to continue for many years to come.

In recent years, it has become increasingly evident that there are systematic differences in net investment return between different types of superannuation funds. In particular, Retail funds tend to earn lower risk-adjusted returns on average than other types of funds, as shown in an APRA research publication (Coleman, Esho and Wong, 2006). More recently, APRA (2007) published a ten-year statistical summary of the superannuation industry that, among other things, indicated a lower long-term net return on assets for Retail funds, relative to other types of funds.

This raises the question: why, how and to what extent do differences between trustees in different sectors impact on different long-term performance outcomes? Under the auspices of the Council of Financial Regulators, APRA has undertaken a research project to analyse the investment performance, conduct of trustee duties and the business relationships of large Australian superannuation funds.

To achieve the project's objectives, APRA developed two questionnaires: a qualitative Superannuation Trustee questionnaire focussing on governance policies and practices by trustees and a quantitative Investment Performance questionnaire, focussing on risk-adjusted returns for funds and members. These questionnaires were distributed to all APRA-regulated superannuation funds with total assets exceeding $200 million as at 30 June 2005. Participation was compulsory under section 29EA of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which was invoked through a condition of the Registrable Superannuation Entity (RSE) licence requiring regulated superannuation funds to submit information to APRA from time to time.

The questionnaires were initially developed with input from industry. They were tested and updated following the analysis of a pilot questionnaire of 15 funds conducted in 2005. The questionnaires were subsequently redesigned with further industry input and comments from Treasury. They were then checked in consultation with various industry representative bodies and other government agencies in 2006. These streamlined questionnaires enabled trustees to efficiently provide a significant amount of useful information.

This article describes the data collected from the Superannuation Trustee questionnaire. The results of the Investment Performance questionnaire will be published later. Based on statistical and licensing returns to APRA for June 2005, 196 funds were eligible to participate in the questionnaires. Due to windups and mergers of superannuation funds over the RSE licensing period to June 2006, 187 superannuation funds remained and all completed the Superannuation Trustee questionnaire. This data collection represents virtually the whole population of large superannuation funds.

A complete data collection has been achieved for relevant funds and, with two exceptions, APRA is satisfied that the data are of high quality. Firstly, a number of retail funds are structured as investment platforms and did not provide their long lists of investment managers in their submitted data tables on service providers, as APRA asked only for service providers that provide more than five per cent of any specific fund function. Secondly, some respondents cited protection from privacy laws as a reason for not revealing to APRA trustee director information such as remuneration by their boards. These exceptions do not materially affect the overall findings of the survey.

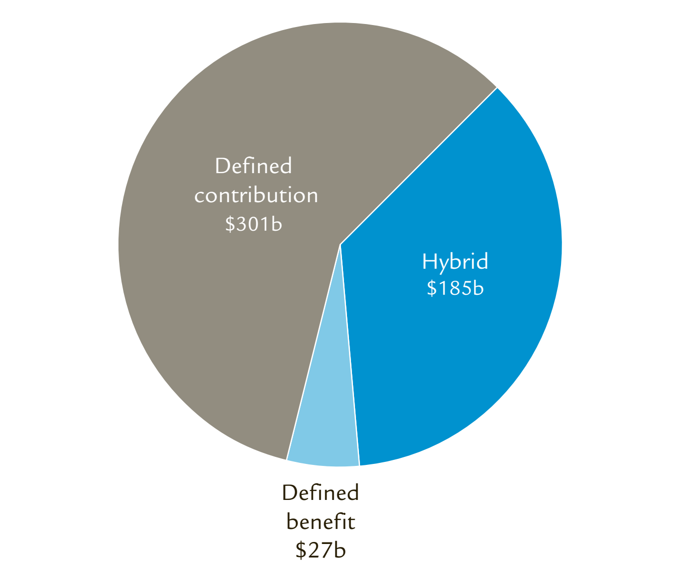
This article presents the results from the Superannuation Trustee questionnaire. Chapter 2 contains an industry overview of trustee governance of the large superannuation funds. Chapter 3 contains an analysis of trustee governance of the funds according to the four major sectors, i.e. Corporate, Public Sector, Industry and Retail. Chapter 4 summarises the findings. An Attachment provides a comprehensive tabulated summary of the collected data, followed by an analysis of the statistical significance of observed differences in governance behaviours between sectors.

Industry overview

Scope of the survey

The Superannuation Trustee questionnaire was sent out in August 2006. Submissions were received in November 2006 from the 187 major superannuation funds in the survey, with aggregate total assets of about $513 billion representing about 85 per cent of the nation's total institutional pension assets in June 2006. All but ten funds have been regulated for five years or more. Only ten funds (5.3 per cent) are exclusively defined benefit, with 114 (61 per cent) being defined contribution and 63 (33.7 per cent) being hybrid, with both defined benefit and defined contribution components. The distribution of total assets by fund type is shown in Figure 1.

Figure 1: Distribution of total assets by fund type



The funds have a total of 1,319 trustee directors employing at least 2,575 service providers to administer and manage investments for 20 million member accounts. In this sample, the averages (arithmetic means) for the funds are seven trustee directors per fund, $2.7 billion in total assets, 107,700 member accounts and at least 14 service providers employed.

Board practice

The funds have an average of 8.1 board meetings per year, with each board meeting having a mean duration of 3.6 hours. The meetings are supplemented on average by 12.8 sub-committee meetings per year, which lead to each trustee director spending on average 98.8 hours per year on fund matters outside board meetings. The funds review the performance of individual trustee directors mostly annually (70.6 per cent) or, in a small minority of cases, every two or three years (4.8 per cent). However, a significant proportion of directors (24.6 per cent) have no regular reviews.

Board policy on directors

More than 90 per cent of the funds do not explicitly require their directors to have formal educational qualifications for their role as trustee directors (Figure 2a). Most funds (81 per cent) do not require their directors to have superannuation or investment experience. However, 68 per cent of the funds require directors to have some formal trustee training.

In contrast to board policy requirements, 65 per cent of directors have university degrees and only 11 per cent of directors have no tertiary qualifications (Figure 2b). Only 8.6 per cent of directors have less than one year of experience on the boards of superannuation trustees, while 56 per cent have five years or more of such experience. Slightly less than 49 per cent of directors have full formal trustee training, as defined by the standards (PS 146) of the Australian Securities and Investments Commission. About 49 per cent have some training and only 3 per cent have no formal training at all. On average, trustee directors have active memberships of 1.6 professional bodies, with 25.9 per cent having no such participation.

Figure 2a: Policy requirements for educational qualifications of board directors

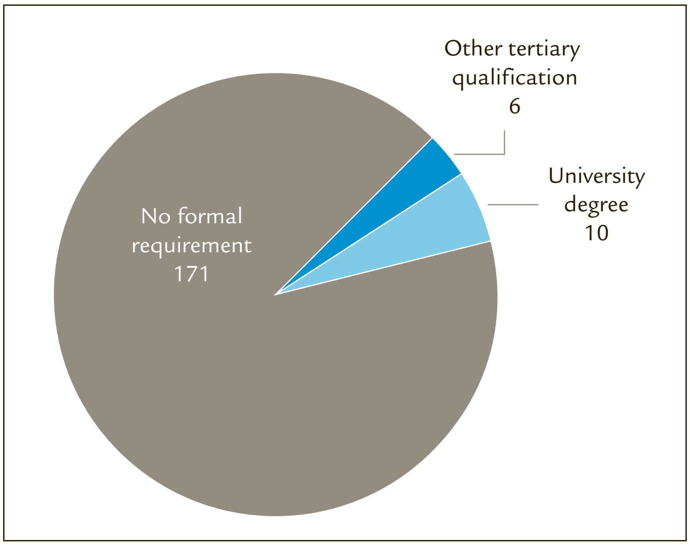
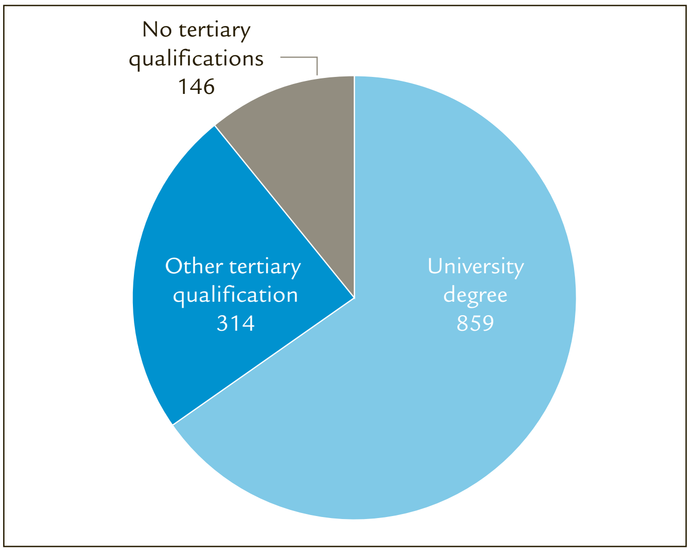


Figure 2b: Actual educational qualifications of board directors



In most cases (about 91 per cent), the funds have no explicit requirements on the number of years a director can serve on the board and none of the funds places any limits on the number of simultaneous directorships a director can hold. The average number of years directors have served on their current boards is 5.3 years and the actual number of other directorships currently held by the directors is 3.5 on average.

Board policy on governance

Most boards (76 per cent) have both independent audit and regular self-assessments to review compliance with the SIS Act and other regulations. The same percentage of funds has a formal policy on arm's-length dealing and documentation on related-party service providers. On director associations with fund service providers, 90 per cent of funds have formal policies to manage potential conflicts of interest, including the use of disciplinary action. However, only 41 per cent of funds have formal policies to forbid the use of 'soft dollar' arrangements, i.e. where indirect payments are made to service providers without being recorded as standard fees or commissions. About 10 per cent of the funds either permit or actually use soft dollar arrangements.

Over the three-year period preceding the survey, funds had conflict of interest issues minuted in board meetings on average 6.6 times for directors and 1.7 times for non-directors. The minutes of board meetings include discussions or declarations of either actual or potential conflicts of interest.

Board priorities

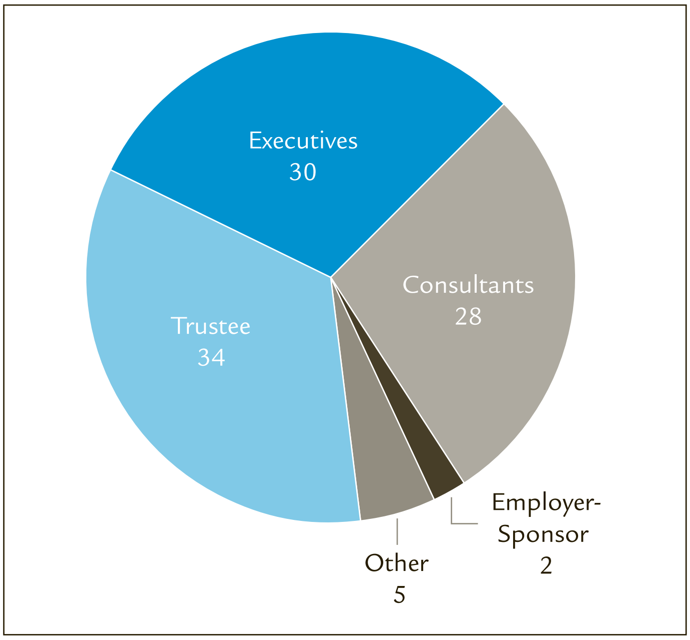
The survey reveals that the highest priority for most trustee boards is 'Ensuring compliance with legislation and regulation'. On a scale from one to ten with one as the highest priority, the trustees rated this priority at 1.9. The second most important priority, with an average rating of 3.8, is 'Reviewing and assessing the fund's investment performance'.

The highest priority measured in terms of the time taken for a task is 'Ensuring compliance with legislation and regulation', which takes an average of 23 per cent of the board's total time. The second most time-consuming task, taking 13.7 per cent of the board's time, is 'Reviewing and assessing the fund's investment performance'.

Board key decision input

Overall, input into key decisions of the trustee board comes mainly from the trustee directors (34 per cent), executives (30 per cent) and consultants (28 per cent), in rounded percentages (Figure 3). Employer-sponsors and others contribute to the remaining 7 per cent of the input to key decisions.

Figure 3: Percentage input to key decisions of the board



Relative to all decision-makers, the trustee directors have the greatest input into administrator selection (54 per cent), asset consultant selection (49 per cent) and setting objectives and risk tolerance (40 per cent). Fund executives have the most input in introducing a new investment option (39 per cent) and consultants have the most influence in benchmark design (41 per cent), investment manager selection (40 per cent), foreign exchange hedging policy (38 per cent), strategic asset allocation (37 per cent) and performance monitoring (35 per cent) of fund investments.

Service providers

Trustees were asked to submit data on service providers that perform more than five per cent of specific functions of their funds, as stipulated in the questionnaire. Of the 2,575 service providers, 1,410 (55 per cent) are investment managers, averaging 7.5 managers per fund. Some 1,082 (42 per cent) are sole service providers of particular types of fund function such as administration or custody. On average, a service provider performs 56 per cent of a particular function of the fund.

The average number of years a service provider is employed by a fund is six years, with 35 per cent of funds using a service provider for three years or less.

About 14 per cent of the service providers have entity relationships with their funds. The most likely relationship was having a common parent company (5.2 per cent). About 11 per cent of the service providers have some associations with board directors, with common directors between service providers and trustees being most likely for 5 per cent of the providers.

The funds pay service providers asset-based fees or flat dollar fees per year, or sometimes both. Funds may not pay any fees to some service providers, either because the service may have been bundled with other paid services or the fees are charged implicitly, such as receiving investment returns net of fees. Of those service providers receiving payments, 1,341 (52 per cent) received an average of 0.31 per cent per annum in asset-based fees and 939 (37 per cent) received an average $704,000 flat fee per year.

Fees to service providers are often (50 per cent) netted off in investment returns without being formally disclosed, while about 25 per cent are disclosed by explicit statement in accounts and 25 per cent stated in fee tables of Product Disclosure Statements (PDS).

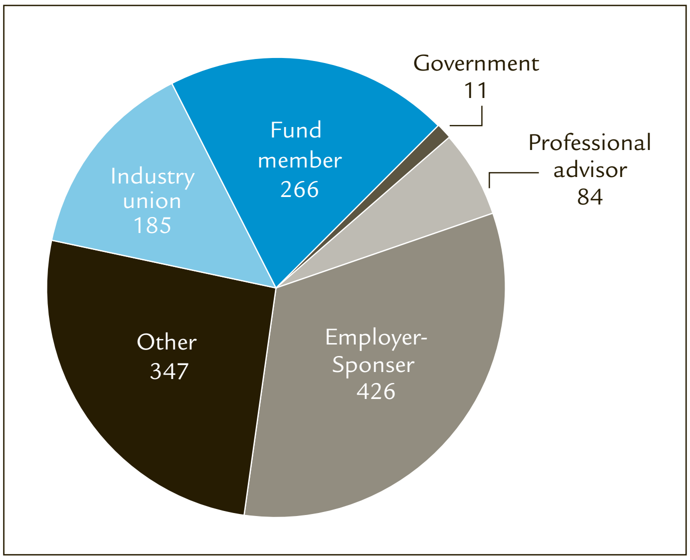
Board directors

The average age of board directors is 53 years, with 37 per cent in their 50s. About 24 per cent (316) of the directors are 45 years or less, 54 per cent (713) are aged between 46 and 60 and the remaining 22 per cent (290) over 60. This age distribution of directors appears consistent with what might be expected from the broader demographic distribution, reflecting generational diversity.

The average number of years directors have served on their current board is 5.3 years, with 64 per cent having served five years or less. The directors have an average of 7.1 years of experience on the boards of superannuation trustees. The primary employers of the directors are mostly employer-sponsors (38 per cent), self-employed (22 per cent) or fund service providers (13 per cent). The directors are employed by their primary employers mainly as senior executives (35 per cent), fund directors (23 per cent) or self-employed (15 per cent).

On the average trustee board, 32 per cent of the directors are employer-sponsor representatives, 26 per cent do not represent any specified interest group (but may be executives) and 20 per cent are fund member representatives. Board directors are mostly appointed internally (30 per cent) or nominated by employer-sponsors (28 per cent), members (16 per cent) or trade unions (14 per cent).

Figure 4: Distribution of types of representation of board directors



Those directors who are paid by the trustee board receive average remuneration of approximately $38,000. Some 54 per cent of directors were either not paid by the board or did not declare their pay. On average, trustee directors invest 40 per cent of their own superannuation in the funds they govern or manage, with 34 per cent putting in all of their own superannuation. Some 48 per cent of directors do not put any of their own superannuation in their funds. About 20 per cent of the directors have a family member invested in the fund that the director governs or manages.

There are 462 directors (35 per cent of total directors) who have one or more declared associations with service providers. Of these directors, 47 per cent have single associations where trustee directors are also directors of the service providers, 22 per cent are simply in paid employment by the service providers, 10 per cent have shareholder or other relationships with the service providers and 21 per cent of the directors have two or more such associations with the service providers. Where a director does obtain regular remuneration from a service provider, the average pay per year given by the service provider is $175,000.

Trustee Governance of the Funds by Sector

This Chapter highlights some of the differences in survey responses between fund sectors that have been found to be statistically significant. A full summary of the survey responses will be published separately in an APRA working paper.

All funds in the Superannuation Trustee survey have more than four members. *Corporate* funds are regulated superannuation entities established for the benefit of employees of one or more related entities, with joint member and employer control. *Public Sector funds* are superannuation entities that provide benefits for Government employees or are schemes established by a Commonwealth, State or Territory law. *Industry funds* are regulated superannuation entities that provide for employees working in one or more industries. *Retail funds* are superannuation funds that offer superannuation products to the public on a commercial basis. About one-third of the Industry funds in the survey are public offer funds, which offer or intend to offer superannuation interests to the public on a commercial basis.

Industry and Retail funds together account for 70 per cent of the population of funds, 81 per cent of the assets and more than 93 per cent of the members. These two sectors contain the vast majority of the public offer funds. As Table 2 shows, more than 75 per cent of the funds in these sectors are defined contribution funds with the rest being defined benefit funds or hybrids (mixtures of the two types). In contrast, less than 20 per cent of the funds in the other sectors are defined contribution funds.

Table 3 shows Corporate funds are mostly medium to small in asset size, with only five out of eight (12.5 per cent) being large (more than $2 billion in assets). Public Sector funds are mostly large to medium, with only one out of 16 (6.3 per cent) being small (less than $0.5 billion in assets). Industry and Retail funds also tend towards the large to medium end of the size spectrum, with 15 out of 55 (about 27 per cent) and 17 out of 76 (about 22 per cent) of these funds, respectively, being small.

Table 1: General Statistics by Sector

Statistics	Corporate	Public Sector	Industry	Retail	Total
Number of funds	40	16	55	76	187
Total assets ($B)	43	52	150	268	513
Membership (Million)	0.38	0.86	9.55	9.35	20.14
Av member per fund (Thousand)	10	54	174	123	108
Av member A/C balance ($K)	113	60	16	29	25

Table 2: Fund Type Distribution by Sector

Fund Type	Corporate	Public Sector	Industry	Retail
Defined benefit/Hybrid	35	13	13	12
Defined contribution	5	3	42	64
Defined contribution (%)	13	19	76	84

Table 3: Asset Size Distribution by Sector

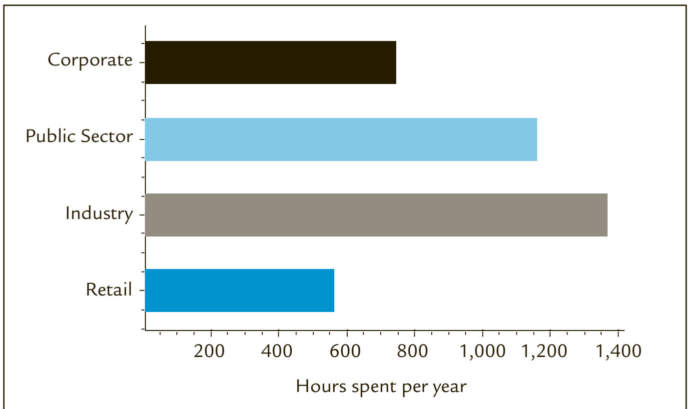
Size	Corporate	Public Sector	Industry	Retail	Total
Large (> $2B)	5	8	19	31	63
Medium ($0.5B to $2B)	18	7	21	28	74
Small (< $0.5B)	17	1	15	17	50
Total	40	16	55	76	187

Board Practice

A number of aspects of board practice have been found to differ across fund sectors in a statistically significant way, as summarised in Table 4.

Taking into account the number of directors, the number of hours spent in board meetings and the number of hours spent on fund matters outside board meetings, the amount of effort in director time spent for each fund can be estimated. Figure 5 shows that, on average, industry fund directors spent the most time inside and outside board meetings for the fund (1,364 hours). In contrast, Retail fund directors spend the least amount of time at an average of 559 hours.

Figure 5: Average number of director hours spent per fund per year



Board Policy on Directors

More often than funds in other sectors, Corporate and Retail funds require their directors to have formal educational qualifications and superannuation or investment experience. These funds have low percentages of trustee directors with no tertiary qualifications, at 10 per cent and 3 per cent respectively, while 17 per cent of trustee directors in both Public Sector and Industry funds have no tertiary qualifications.

On the other hand, directors of Industry funds usually have formal trustee training. Only 8 per cent of their directors have less than 20 hours of formal training and 31 per cent have full ASIC PS146 competency training.

Most Retail funds (85.5 per cent) undertake annual performance reviews of individual directors, in contrast with Public Sector funds where only 37.5 per cent undertake annual performance reviews, 6.3 per cent undertake less frequent reviews and 56.2 per cent have no regular reviews.

Board Policy on Governance

As mentioned above, most funds in the survey have formal policies on trustee governance, particularly in relation to reviewing compliance with the SIS Act and other regulations.

The minority of funds that do not have policies on some aspects of governance are therefore noteworthy and they differ across sectors. Table 5 collects responses from several questions where there is no board policy on some aspects of trustee governance. Some 33 per cent of Corporate funds have no specific policy on related-party service providers. Between 33 per cent and 44 per cent of all funds either permit and use soft dollar arrangements or have no specified policy on such arrangements.

Table 4: Board Practice Distribution by Sector

Board Practice	Corporate	Public Sector	Industry	Retail
Average number of directors per fund	7.8	7.1	8.8	5
Average number of board meetings pa	6.7	9.1	7.5	9.1
Average hours per board meeting	3.9	4.4	4.8	2.4
Average number of subcommittee meetings pa per fund	13.1	15.1	14.7	10.7
Average hours spent pa per director outside board meetings	69	123	119	90

Board Priorities

Boards were asked to rank key tasks in terms of priority on a scale from one to ten, with one being the highest priority. They were also asked to rank the same key tasks in terms of time taken as a percentage of the total time spent by the boards.

'Ensuring compliance with legislation and regulation' is ranked on average as the highest priority by funds in all sectors except Public Sector funds, which rank this as the second priority behind 'Determining and implementing the fund's asset allocation'.

The next highest priority selected by both Corporate and Retail funds is 'Reviewing and assessing the fund's investment performance', while Industry funds selected as their next priority 'Determining and implementing the fund's asset allocation'.

'Ensuring compliance with legislation and regulation' also takes the most time for the board of all sectors except Public Sector funds, which spend more time on average in 'Reviewing and assessing the fund's investment performance'. This latter task is the next most time-consuming task for Industry and Retail funds, while for Corporate funds this task is 'Other (including insurance claims, consulting with actuaries and auditors and other board tasks)'.

Table 5: Absence of board policy by sector

Key Task	Corporate	Public Sector	Industry	Retail
No policy on related party	33	13	22	5
No policy on director associations	13	13	15	1
No policy on soft dollar arrangements or are permitted	43	44	35	33
No regular review of directors	20	56	33	15

Table 6: Average Priority Rankings of Key Tasks

Key Task	Corporate	Public Sector	Industry	Retail
Determining and implementing the fund's asset allocation	3.7	3.1	3.2	6.4
Selecting and assessing investment managers	5.8	5.2	5.4	4.9
Selecting and assessing the administrator	5.5	5.8	5.4	5.1
Selecting and assessing asset consultants	7.4	6.9	6.5	8.4
Reviewing and assessing the fund's investment performance	3.5	4.4	3.8	3.8
Assessing quality of member services/needs of members	5.4	4.3	4.7	4.4
Communicating and making presentations to employer-sponsors, members or advisors**	7.1	8.3	8.6	7.6
Assessing the fund's competitiveness (on fees, product offering etc)	8.4	6.6	6.9	6.4
Ensuring compliance with legislation and regulation	1.6	3.4	2.3	1.4
Other (including insurance claims, consulting with actuaries and auditors and other board tasks)	6.5	7.0	8.2	6.7

Board Key Decision Input

Table 8 shows that the trustee board has the greatest influence in key decisions in the Corporate sector, where the trustee is the main source of input to five out of ten key decisions. Asset consultants are the main source of input for 50 per cent or more of the key decisions for all funds, except Retail sector funds.

Even though the trustees ultimately make the decisions, executives of Retail funds (who may also be trustee directors) are the principal source of input to key decisions, with the trustees the main source only on administrator selection. As Figure 6 shows, trustee directors on average have more input to key decisions in the Corporate and Industry sectors than those in the other sectors.

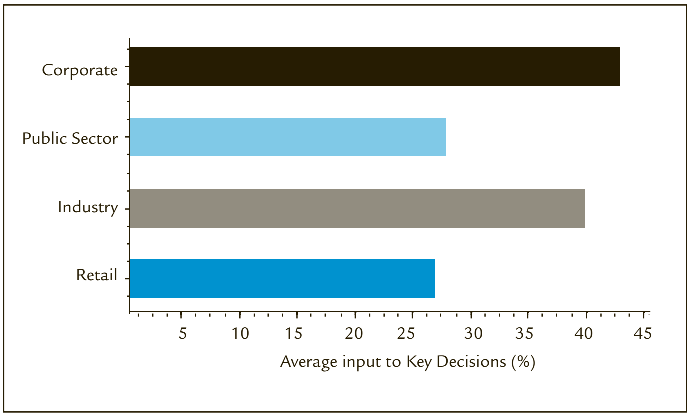
Table 7: Average Time Taken (%) by Boards on Key Tasks

Key Task	Corporate	Public Sector	Industry	Retail
Determining and implementing the fund's asset allocation	7.6	11.3	10.2	5.6
Selecting and assessing investment managers	7.3	10.7	10.2	8.1
Selecting and assessing the administrator	8.0	8.8	7.7	8.2
Selecting and assessing asset consultants	4.7	4.2	5.1	3.6
Reviewing and assessing the fund's investment performance	13.8	14.7	15.4	12.2
Assessing quality of member services/needs of members	7.5	11.4	10.9	11.6
Communicating and making presentations to employer-sponsors, members or advisors	6.5	4.4	4.8	5.5
Assessing the fund's competitiveness (on fees, product offering etc)	5.2	7.1	7.1	6.9
Ensuring compliance with legislation and regulation	23.2	14.4	17.5	28.7
Other (including insurance claims, consulting with actuaries and auditors and other board tasks)	16.2	13.1	11.0	9.5

Table 8: Main Sources of Input to Key Decisions by Sector

Key Decision	Corporate	Public Sector	Industry	Retail
Objectives and risk tolerance	Trustee	Consultant	Trustee	Executive
Strategic asset allocation	Consultant	Consultant	Consultant	Executive
Benchmark design	Consultant	Consultant	Consultant	Executive
Investment manager selection	Consultant	Consultant	Consultant	Executive
Performance monitoring	Consultant	Consultant	Consultant	Executive
Introducing a new fund option	Trustee	Executive	Trustee	Executive
Default option asset allocation	Trustee	Consultant	Consultant	Executive
Asset consultant selection	Trustee	Trustee	Trustee	Executive
Administrator selection	Trustee	Trustee	Trustee	Trustee
Foreign exchange hedging policy	Consultant	Consultant	Consultant	Executive

Figure 6: Trustee input to key decisions



Service Providers

On average, Industry funds and Public Sector funds use 22.6 and 20.5 service providers per fund, well ahead of Corporate funds that use 12.3 service providers. Excluding 26 Retail funds that operate as investment platforms and use potentially very large numbers of investment managers, other Retail funds use an average of 6.8 service providers per fund.

Apart from platforms, which are administrative structures capable of handling many different types of managed investments, Retail funds use relatively few service providers but rely more heavily than average on each service provider. Industry funds use the largest number of service providers because they tend to use several service providers for a particular function, such as managing Australian equity investments. This is consistent with the statistic that the average percentage of a particular function serviced by a provider is the lowest for Industry funds (42 per cent). This compares with Public Sector funds (58 per cent), Corporate funds (68 per cent) and Retail funds (76 per cent), excluding platforms.

Table 9: Service Providers Employed by Sector

Function Provided	Corporate	Public Sector	Industry	Retail
Administration	46	12	62	60
Custody	20	14	43	66
Insurance	36	14	82	82
Investment policy and strategy formulation	8	9	17	4
Investment: Australian listed equity	58	57	186	27
Investment: International listed equity	55	55	156	16
Investment: Australian fixed interest	18	14	58	7
Investment: International fixed interest	18	13	44	7
Investment: Australian listed property	8	9	31	7
Investment: Australian direct property	19	14	62	1
Investment: Cash instruments	12	10	43	16
Investment: Multiple asset classes	12	9	40	31
Investment: Multiple funds	1	5	10	15
Investment: Other (hedge fund etc)	28	32	160	8
Asset consulting	27	8	47	22
Implemented consulting	10	1	7	4
Actuarial service	40	12	22	18
Auditing	40	20	72	69
Legal service	36	14	80	41
Sales and marketing	0	5	20	12
Total	492	327	1242	513

The average number of years a service provider is employed by the fund is lowest for Public Sector and Industry funds, at 5 years and 5.1 years respectively, compared to 7 years for Corporate funds and 7.5 years for Retail funds.

Retail funds are much more likely to use service providers that are related parties, because they often operate within broader financial conglomerate structures. Typically, the provider is the parent company of the trustee, or the provider and trustee have a common parent company. Such relationships are found in 39 per cent of Retail funds, 10 per cent of Corporate funds and not at all in the other funds. The existence of such relationships also increases the likelihood of associations of service providers with board directors. Such connections include provider and trustee having common directors or a provider having trustee directors in paid employment. Such associations are found in 33 per cent of Retail funds, 10 per cent of Corporate funds and 5 per cent of Public Sector and Industry funds.

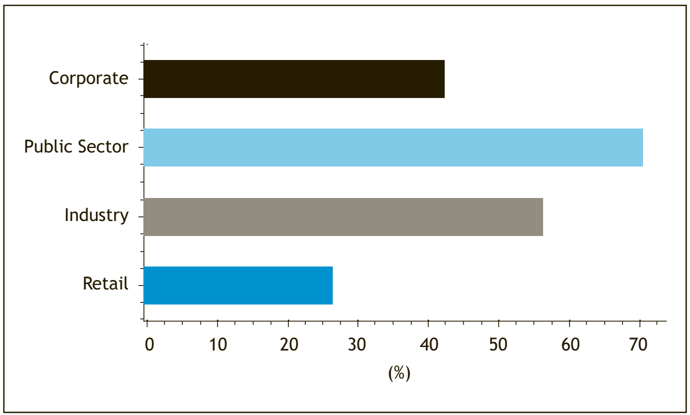
Service providers of Public Sector and Industry funds are more likely (66 per cent and 59 per cent respectively) to be paid asset-based fees as a percentage of the assets serviced per year rather than a flat dollar fee, for which the relevant figures are 34 per cent and 39 per cent, respectively. The average asset-based fees for these sectors are 0.35 per cent and 0.37 per cent per annum of assets serviced, respectively. The asset-based fees paid by 46 per cent of Corporate and 33 per cent of Retail funds are lower at 0.26 per cent and 0.18 per cent per annum, respectively. However, Corporate and Retail funds almost as often pay flat dollar fees to service providers (37 per cent and 31 per cent respectively).

A service provider is considered to explicitly disclose its fees if the fees are disclosed by statements in financial accounts or in a PDS. As Figure 7 shows, the fees to service providers are often not explicitly disclosed; rather, they are charged implicitly by being netted off in investment returns.

Table 10: Distribution of the Number of Years Service Providers are Employed by Sector

Years Service Provider Employed	Corporate	Public Sector	Industry	Retail
Less than 1	24	35	136	18
1	54	49	181	78
2	84	62	136	49
3	49	32	139	47
4	36	20	109	49
5	37	24	117	23
6	28	20	75	51
7	18	7	48	27
8	30	14	58	36
9	2	17	30	17
10	31	9	65	16
11	10	4	24	14
12	4	6	28	1
13	3	2	13	0
14	7	1	9	7
15	15	7	12	2
16	4	9	7	3
17	0	0	4	4
18	0	2	8	2
19	6	0	18	0
20	8	0	5	7
More than 20	42	8	18	62

Figure 7: Percentage of service providers whose fees are not explicitly disclosed



Retail funds often (49 per cent) state their fees indicatively in tables in the PDS of their funds. The use of PDS for disclosure of information to retail investors is a requirement of retail managed investment funds regulated by the Australian Securities and Investment Commission. About 21 per cent of Industry and Corporate funds use the PDS method for fee disclosure, while Public Sector funds rarely (4.3 per cent) use this method.

The explicit statement of fees by service providers in financial accounts is relatively infrequent, with Corporate funds disclosing fees in this manner 36 per cent of the time, followed by Public Sector funds at 25 per cent, Retail funds at 23 per cent and Industry funds at 22 per cent of the time.

Board directors

On average, board directors of Public Sector and Industry funds are older (56 and 55 years respectively), have more experience on trustee boards (8.2 and 8.5 years) and served longer on their current boards (6.5 and 6.7 years) than directors of Corporate and Retail funds. For Corporate and Retail directors, average ages are 50 and 51 years, average years of trustee experience are 6 and 5.8 years and years of service on their current boards are 4.3 and 3.9 years.

Between 52 per cent and 57 per cent of all directors in any sector belong in the 46-60 years age group. Corporate and Retail funds have more directors (32 per cent and 30 per cent) in the 45 or less age group and fewer (12 per cent and 18 per cent) in the over 60 age group. The situation is reversed for the other two sectors. Public Sector and Industry funds have fewer directors (10 per cent and 17 per cent) in the 45 or less age group and more (33 per cent and 29 per cent) in the over 60 age group.

Table 11: Service Provider Relations to Funds by Sector

Service Provider Relationship to the Fund	Corporate	Public Sector	Industry	Retail
Provider is the parent company of the trustee	25	0	0	86
Provider and trustee have common parent company	25	0	4	105
Provider is a wholly owned subsidiary of the trustee	0	0	7	0
Two of the above	1	0	0	0
No relationship	433	308	1161	313
Other relationship	8	20	70	9

Table 12: Distribution of director remuneration by trustee boards

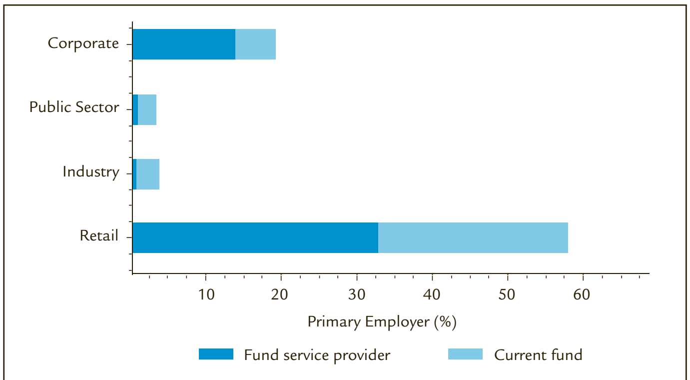
Remuneration (% of Directors)	Corporate	Public Sector	Industry	Retail	Total
(Up to $50K pa)	88	81	89	57	82
($50K to $100K pa)	10	17	10	23	14
(More than $100K pa)	3	2	1	20	5

Retail fund directors hold on average seven other directorships simultaneously, compared with 1.7 directorships for Corporate, 1.9 for Public Sector and 2.4 for Industry fund directors.

If board directors whose job types are managers or employees are defined as 'rank and file' board directors, Corporate funds have the largest average proportion (47 per cent) of rank and file board directors. Public Sector and Industry funds follow with 26 per cent and 27 per cent rank and file directors, respectively. Trustee directors of Retail funds are mainly senior executives (40 per cent) or professional directors (53 per cent) and only 7 per cent come from outside those job types.

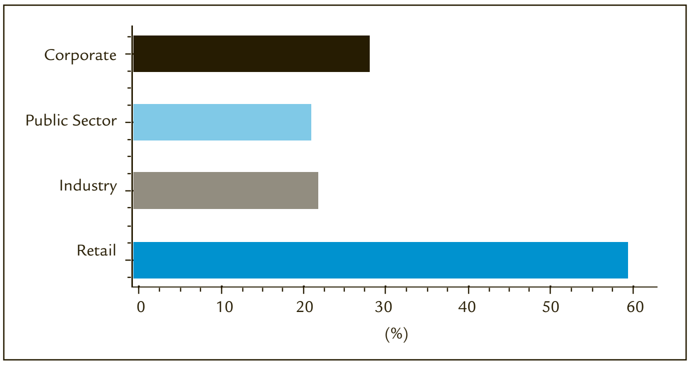
Employer-sponsors are the primary employers of the trustee directors for Corporate funds (72 per cent), Public Sector funds and Industry funds (both 40 per cent), while only 6 per cent of the directors of Retail funds have employer-sponsors as their primary employers. Industry unions are the primary employers of 14 per cent and 26 per cent of the directors of Public Sector and Industry funds, respectively. A significant proportion (25 per cent) of directors of Retail funds are primarily employed by their current fund compared with 5 per cent for Corporate funds and 3 per cent each for Public Sector and Industry funds. As Figure 8 shows, many Retail directors are primarily employed either by their current funds or by service providers to their funds and the proportions are substantially higher than those in other sectors.

Figure 8: Percentages of board directors whose primary employer is a fund service provider or the current fund



Apart from being in the paid employment of the service provider, other forms of association for a director include being a director of the service provider and being a shareholder of the provider. Directors of Corporate funds are more likely to have two or more such associations with service providers at the same time. The proportions of trustee directors who have one or more associations with a fund service provider are shown in Figure 9. Directors of Retail funds are more than twice as likely as directors of other funds to have associations with service providers.

Figure 9: Percentage of board directors with one or more associations with a fund service provider



Averaged over 602 directors who supplied data on remuneration paid by trustee boards, directors of Retail funds are generally most well-paid by their trustee boards, with 20 per cent of directors earning greater than $100,000 per year (Table 12). Their average pay of $70,000 per year is about double that of directors in other sectors.

Averaged over 192 directors who supplied data on remuneration paid by service providers, directors of both Corporate and Retail funds are generally most well-paid by service providers, with 67 per cent to 69 per cent of directors earning greater than $100,000 per year (Table 13). Their average pay of more than $200,000 per year is well above that of directors in the other two sectors.

Table 13: Distribution of director remuneration by service providers

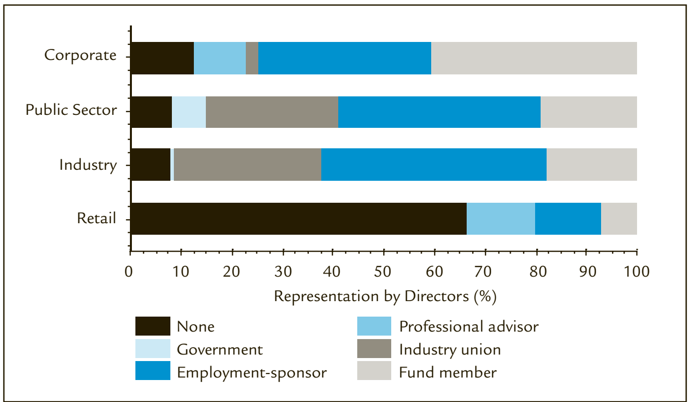
Remuneration (% of Directors)	Corporate	Public Sector	Industry	Retail	Total
(Up to $50K pa)	7	90	91	17	41
($50K to $100K pa)	26	10	7	14	14
(More than $100K pa)	67	0	2	69	45

Corporate funds have the highest proportion of directors (75 per cent) representing the two main groups of 'stakeholders', i.e. employer-sponsors (34 per cent) or fund members (41 per cent). This reflects the requirement that the boards of corporate trustees should have equal representations of members and employers. The proportion of directors representing the two main stakeholder groups is 63 per cent for Industry funds, 59 per cent for Public Sector funds and 20 per cent for Retail funds.

The Public Sector and Industry funds have significant numbers of directors representing industry unions or governments, at 33 per cent and 30 per cent respectively. This reflects the historical origins of these types of funds. Direct government involvement at the board level has declined in favour of individual employer-sponsors for many government agencies as the growth of government defined benefit funds has curtailed.

About 10 per cent and 14 per cent, respectively, of directors in Corporate and Retail funds are professional advisors. The remaining 66 per cent of Retail directors do not represent fund members, employer-sponsors or official bodies, as Figure 10 shows. These directors are likely to be employees of their current funds or employees of service providers to their funds.

Figure 10: Percentage composition of the types of representation by board directors



The distribution in methods of appointment of board directors is consistent with the distribution in types of representation. Where there are high levels of representation of employer-sponsors and fund members, the method of appointment of board directors is predominantly election by those stakeholders. In contrast, internal appointments and appointments through personal contacts are commonly found on the boards of Retail funds. Figure 11 shows the composition of methods of appointment.

'Personal stake' is relevant as a measure of the extent to which interests of directors and fund beneficiaries are aligned. As Table 14 shows, directors in Corporate, Public Sector and Industry funds are more likely than not to be personally investing in the funds they manage, with average participation rates in their funds of 69 per cent, 73 per cent and 62 per cent, respectively. Retail directors, on the other hand, have an average participation rate of 21 per cent.

Furthermore, on average directors of Corporate funds have the highest stakes (63 per cent) of their total personal superannuation in their funds; for those Corporate directors who do invest in their funds, the stakes are 92 per cent. The comparable figures for directors of Public Sector funds are 56 per cent (77 per cent), for Industry funds 44 per cent (71 per cent) and Retail funds 12 per cent (57 per cent) of their own personal superannuation.

Figure 11: Percentage composition of the methods of appointment of board directors

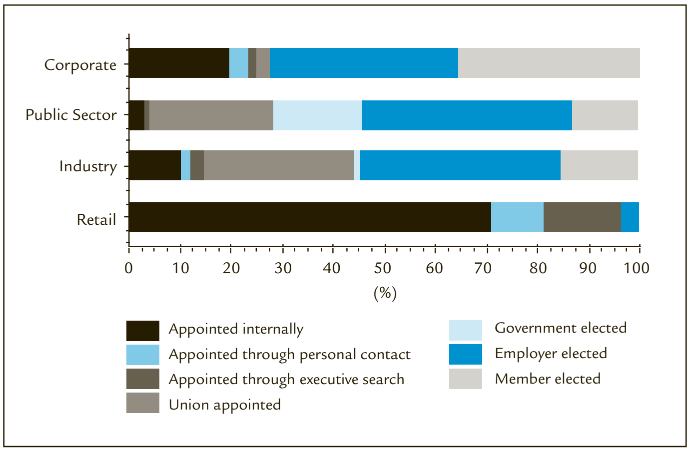


Table 14: Personal Stake characteristics of board directors by Sector

Characteristic (%)	Corporate	Public Sector	Industry	Retail
Director personally in the fund	69	73	62	21
Av personal super of all directors in the fund	63	56	44	12
Av personal super of only those who do invest	92	77	71	57
Av family member of director in the fund	8	17	32	15

On average, 32 per cent of family members of directors of Industry funds are also members of their superannuation funds. Family membership of Corporate funds is the lowest at 8 per cent. In general, family members of directors of Corporate and Public Sector funds cannot participate in their funds unless they also work for the same employer. Corporate and Public Sector funds are usually non-public offer funds. About one-third of the Industry funds (18 funds) and all Retail funds (76 funds) in the survey are public offer funds, in which family members and others can participate.

Industry funds have on average 0.32 family members per director in the fund, given that there are 157 family members for 498 directors. This number rises to 0.95 when adjusted for the fact only about one-third of the directors are from public offer funds. Retail funds have on average 0.15 family members per director in the fund, given that there are 60 family members for 389 directors. This suggests that directors of public offer Industry funds are about six times more likely than Retail fund directors to have family members in their funds.

Summary of Findings

Despite minimal formal requirements by trustee boards, directors are generally well qualified, with 65 per cent having university degrees. They are likely to be in their 50s and have on average several years of trustee or investment experience, with 56 per cent having five years or more experience. Directors of Public Sector and Industry funds are generally a few years older and more experienced than directors of Corporate and Retail funds.

The effort expended by directors in running their funds ranges from 559 director hours per fund per year for the average Retail fund to 1,364 director hours for the average Industry fund. Retail directors hold on average seven other simultaneous directorships, well above the next highest at 2.4 simultaneous directorships held by directors of Industry funds.

Most boards (76 per cent) have both independent audit and regular self-assessment to review compliance with the SIS Act and other regulations. They place high priorities and spend high percentages of their time (averaging 23 per cent) to ensure compliance with legislation and regulation. Soft dollar arrangements are apparently in common use in the industry, although 41 per cent of funds have formal policies to forbid their use.

Asset consultants have the main input to more than half of the key decisions of Corporate, Public Sector and Industry funds, with the trustees having the main influence in the other key decisions. Executives provide the main input to all key decisions of Retail funds, except for administrator selection where the trustees provide the main input.

Service providers are widely used in the superannuation industry, with the average fund using more than 13 service providers. About 55 per cent of the service providers are investment managers. In more than half of the cases, fees to service providers are not explicitly disclosed in financial accounts, but are implicitly charged through lower returns to the funds.

Directors of Corporate, Public Sector and Industry funds are more likely to hold jobs as employees and managers. Retail directors are mainly (93 per cent) senior executives and directors, whose primary employers are often (33 per cent) service providers. Over 60 per cent of Retail directors have one or more associations with service providers. This is more than twice as frequent as directors of Corporate funds and about three times as frequent as those of Public Sector or Industry funds.

Directors of Corporate, Public Sector and Industry funds are largely (59 per cent to 75 per cent) drawn from stakeholders such as employer-sponsors and fund members, and to a lesser extent (3 per cent to 33 per cent) from industrial unions and government. In contrast, only 20 per cent of Retail directors are drawn from particular stakeholders or official bodies, a majority (66 per cent) representing none of those interests.

Public Sector funds have 97 per cent of their directors appointed from outside the board by employer-sponsors, fund members, industrial unions or government or through executive search firms. Industry and Corporate funds follow at 88 per cent and 76 per cent, respectively. However, only 19 per cent of directors of Retail funds are appointed from outside the board, with 4 per cent being elected by employer-sponsors and 15 per cent through executive search firms. The remaining 81 per cent of appointments are made internally by the board or through personal contacts.

Board remuneration of Retail directors is typically double that of directors in other sectors. Directors of Corporate and Retail funds can receive substantial regular payments (greater than $200,000 on average) from service providers, who may be primary employers of those directors. These payments from service providers are well in excess of similar payments to directors in other sectors.

Directors of Corporate, Public Sector and Industry funds are more likely (62 per cent to 73 per cent) to invest their personal superannuation in their own funds than directors of Retail funds (21 per cent). When these directors do have personal stakes in their funds, their investments as a percentage of their total superannuation are more substantial (71 per cent to 92 per cent) than those of directors in Retail funds (57 per cent). Among public offer funds, directors of Industry funds are six times more likely than directors of Retail funds to have family members in their funds.

To sum up, this paper provides a detailed study of superannuation fund governance in Australia. The results show some systematic and statistically significant differences in trustee governance practices between sectors.

Research is underway to study the relationship between fund governance by trustees and investment performance of funds by linking the findings of the Superannuation Trustee survey with the results of the complementary Investment Performance survey.

Authors

Wilson Sy, Chris Inman
Policy, Research and Statistics Division

Neil Esho
Bank for International Settlements

Ranuka Sane
University of New South Wales

References

APRA (2007): "Celebrating 10 Years of Superannuation Data Collection 1996-2006", APRA Insight Issue 2, 2007 (Special Edition) available online at http://www.apra.gov.au.

Coleman, A. D. F., Esho N., and Wong, M. (2006): "The Impact of Agency Costs on the Investment Performance of Australian Pension Funds", *Journal of Pension Economics and Finance* Vol. 5, No. 3, pp.299-324.

Acknowledgement

The authors are grateful for helpful comments by staff from APRA and from other member organisations of the Council of Financial Regulators.