



Issues and Challenges in Governance

Australia

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Introduction & Overview

Introduction

In superannuation, governance and culture are perhaps even more important as protecting the best interests of fund members is so heavily reliant on trustees doing the right thing...

Helen Rowell

Deputy Chairman, APRA (2016)

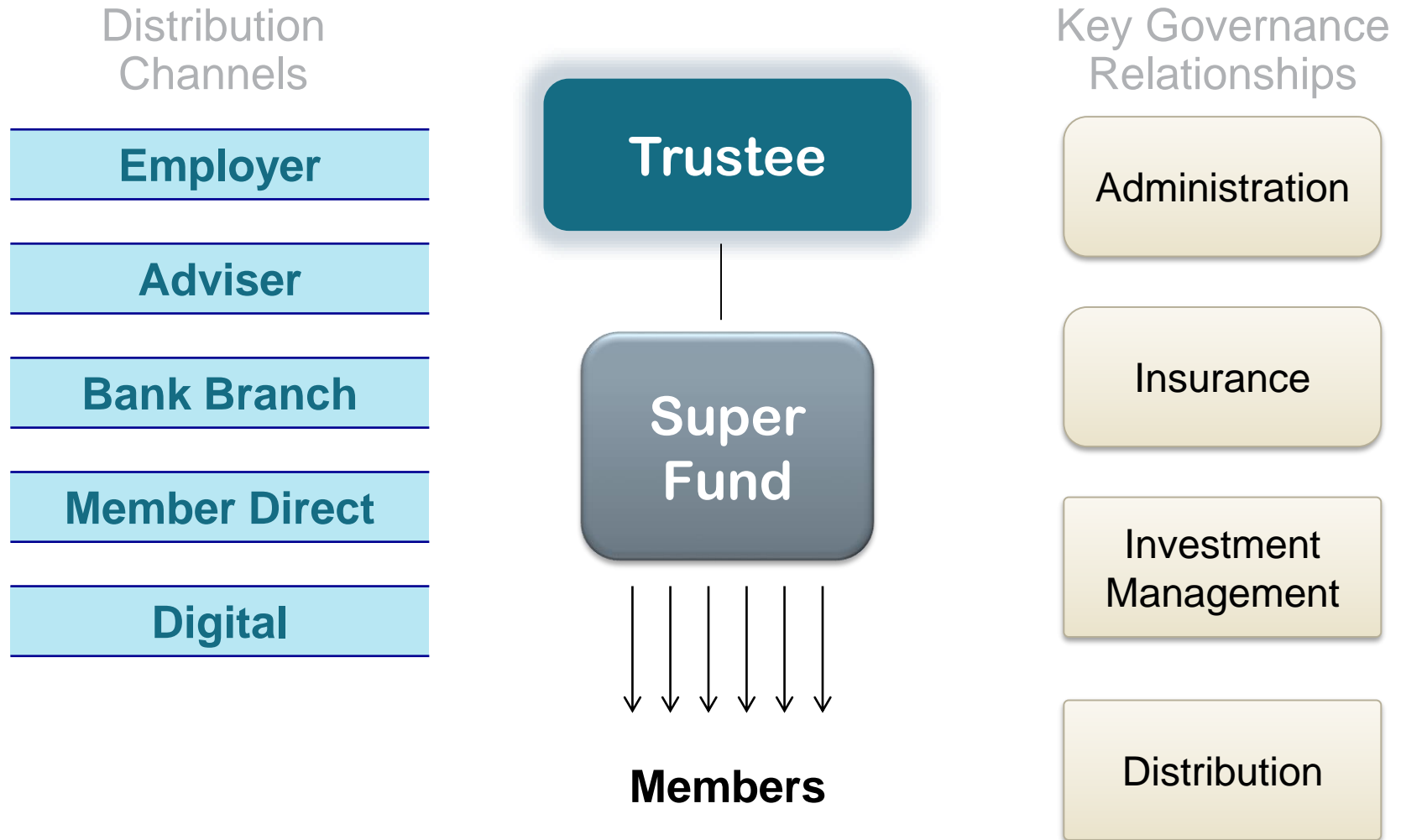
Some Basic Features of the Super System

- **Types of Funds:**

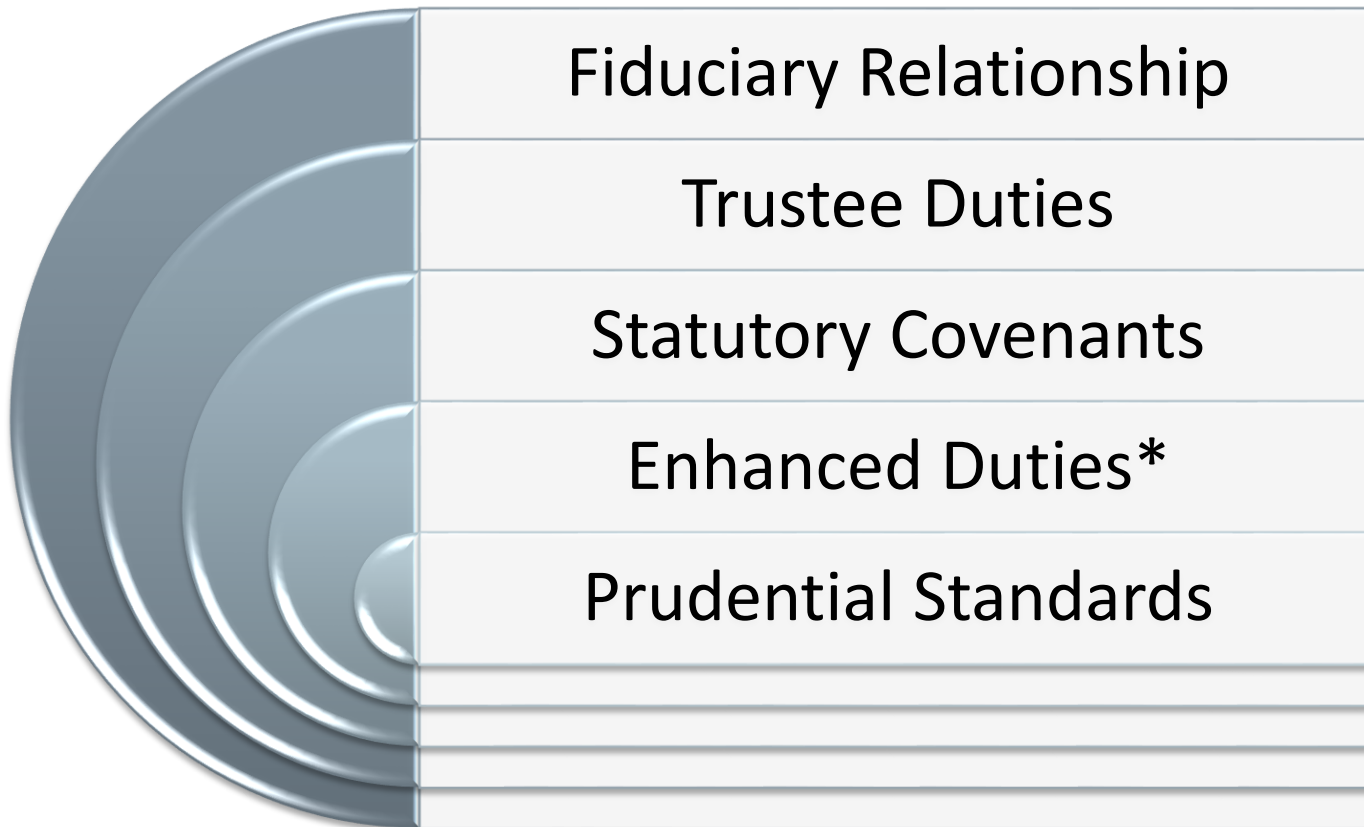
Corporate Funds	Industry Funds
Retail	Public Service
SMSF (Self Managed Superannuation Funds)	

- **Compulsory contributions**
- **“Choice” of fund environment / MySuper**
- **Accumulation based (most DB are closed)**
- **Regulators:**
 - APRA (Australian Prudential Regulation Authority)
 - ASIC (Australian Securities and Investment Commission)
- **Legislation**
 - *Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act)*
 - *Corporations Act 2001(Cth) (Corps Act)*

Key Relationships for a Super Trustee



A Layered Governance Approach



*Apply only in respect of MySuper products, and are not addressed in this presentation

Fiduciary Relationship

- **Nature of Fiduciary Obligations**

- Proscriptive in nature
- Twin Obligations:

No Profit Rule: not to obtain any unauthorised profit from the relationship

No Conflict Rule: not to be in a position of conflict

Breen v Williams (1996) 186 CLR 71

- **NOT** a prescriptive duty – no positive obligation to act (ie acting in the best interests...)
- Best interest obligations – arise from trust law / statute

Application to Relationships

- Presumptive / Non-presumptive relationships
- Trustee and Beneficiary (ie superannuation fund)
- Advice relationship

Trustee Duties and Covenants

- **Trustee Covenants (13) implied into the governing rules of super trusts - cannot be modified**
- **Selected covenants:**

Honesty

**Care, skill and
diligence of a
prudent
superannuation
trustee**

**Best interests of
beneficiaries**

**Duty of Priority
(in the event of a
conflict)**

**Acting fairly
(between classes;
within a class)**

**Investment,
Insurance, and
Risk Covenants**

- **Consistency with general Trust Law?**
- **Stronger Super reform - extension to DIRECTORS**

Prudential Standards

Set of 13 Prudential Standards issued by APRA (that have the force of law)

APRA's power to issues standards – “prudential matters”

Outsourcing

- Outsourcing policy - material business activities
- Assessment of outsourcing options
- Legally binding agreement - must cover specified requirements
- Monitoring

Investment Governance

- Investment Governance Framework
- Investment strategy for the whole fund, and each option
- Formulate specific and measurable investment objectives for each option, including return and risk objectives;
- Due diligence / Monitoring / Review
- Liquidity Planning

Prudential Standards

Insurance

- Insurance Management Framework
- Insurance Strategy
- Policies and Procedures – admin / underwriting / claims
- Selection / Monitoring Insurer
- Insurance Arrangement

Risk Management

- Risk Management Framework
- Risk Management Strategy
- Risk Appetite Statement
- Written business plan – strategic direction for managing business operations
- Adequate resources

Prudential Standards

Conflicts

- Conflicts Management Framework
- Conflicts policy
- Registers of relevant interests and relevant duties

Governance

- Policy on Board renewal / procedures for assessing Board performance
- Board remuneration committee
- Remuneration policy that aligns risk management and remuneration
- Board audit committee
- Internal audit function

Fit and Proper

- Fit and Proper policy
- Assessment prior to appointment

Triennial Reviews - Independent



Spotlighting Issues of Governance

An Intensity of Focus...



Conflicts and Vertical Integration
Insurance Obligations
Obligation of Employers
Trustee Boards
Risk Culture

Conflicts and Vertical Integration

Insurance Obligations

Obligation of Employers

Trustee Boards

Risk Culture

Conflicts and Vertical Integration

- Intense focus from APRA and ASIC
- Stronger Super – “De-entrenchment reforms”
 - General Law – trust deed can modify general law
 - BUT De-entrenchment reform:

Provision in trust deed is void *to the extent* that it specifies:

- a person (whether by name **or in any other way, directly or indirectly**) from whom the trustee **may or must** acquire a service.
- an entity (whether by name **or in any other way, directly or indirectly**) in or through which assets of the **fund may or must** be invested.

Conflicts and Vertical Integration

- **Particular focus on vertical integration:**
 - **ASIC Report:** Culture, Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry
 - Product manufacturing / Product Distribution
 - Outsourcing to related party
 - Investing in a related party

Insurance Obligations

Under the Spotlight: Trustee and Insurer relationship

- Benefits typically offered in a super fund:
 - Death benefits
 - Total and permanent disablement (TPD)
 - Salary continuance insurance (SCI)

Covenant: Trustee is to do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if the claim has a reasonable prospect of success.

SIS Act s 52(7)(d)

Issue: What are the governance expectations for Trustees?

Employers – powers and discretions

UK Position

- Powers or discretion conferred on an employer in the trust deed of a pension scheme must be exercised in accordance with the implied obligation of mutual trust and confidence - *Imperial Tobacco case*
- Direct application of the implied obligation that limits employer power in contracts of employment - *Malik case (House of Lords)*

Australian Position

- *Commonwealth Bank of Australia v Barker* – High Court of Australia
- Implied Obligation in the *Malik* case – does not apply to employment cases in Australia
- **Upshot** – will not be applied to limit the scope of an employer's power / discretion in a super / pension trust deed

An Alternative Approach?

Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd [1991] 2 All ER 597
Malik v Bank of Credit and Commerce International SA (in liq) [1997] 3 All ER 1
Commonwealth Bank of Australia v Barker [2014] HCA 32

Trustee Boards

Independence on Trustee Boards

- **Current Position:**
 - Equal representation employer / employee representatives for standard employer-sponsored funds
- **Proposal:**
 - Removal of equal representation requirements
 - One third of directors – must be “independent” (including the Chair)
 - Definition of “independent”
 - Challenges with the proposal
 - Proposal now lapsed
- **Is independence the solution?**

Trustee Boards – Number of directors / skills matrix

Governance issues on the road ahead...

- Risk Culture
- Further reforms on independence
- Remuneration incentives in the distribution space
- Retirement options