Working Paper

Superannuation fund governance: An interpretation

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Wilson Sy*

Australian Prudential Regulation Authority
400 George Street
Sydney NSW 2000

Email: Wilson.Sy@apra.gov.au
Phone: 0612 9210 3507

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Like many countries around the world, the Australian pension (superannuation) system is now a critical part of the national economy, particularly for funding the retirement of an aging population. It is projected (Rothman, 2007) that by 2046 only 35% of retirees will depend totally on pensions provided directly by government revenue. The rest will rely partially or entirely on individual pensions self-funded (with tax subsidy) through the Australian pension system.

As one of the institutional pension regulators, the Australian Prudential Regulation Authority (APRA) has undertaken considerable research and statistical analysis over time in the pension industry. In recent years, it has become increasingly evident (Coleman et al., 2006, APRA, 2007) that retail funds earn about 2% a year less than other institutional funds on average over a ten year period. Similar observations have been made in the U.K. for retail unit trusts (Sadler, 2002) and in the U.S. for mutual funds relative to defined benefit pension funds (Bauer and Frehen, 2008).

In 2006, APRA conducted two important surveys: a pension governance survey to study trustee policies and practices and an investment performance survey of the largest funds representing 85% of institutional pension assets. The surveys—meant to examine trustee practices and identify factors that could influence investment performance—were compulsory for all the funds with assets greater than $200 million in June 2005. They followed an initial pilot study and had input from industry representative bodies and other government agencies. The final surveys were streamlined with data validation to enable trustees to efficiently provide a significant amount of useful information.

APRA recently published a comprehensive report on its statistical findings (Sy et al. 2008), with the fund governance survey coverage shown in Table 1. A complementary report on the investment performance survey will be published at a later date. APRA classifies superannuation into four major types or sectors: corporate, public sector, industry and retail. Their findings revealed that in many areas of pension governance, there was little difference between sectors, but in many other areas there were statistically significant differences between retail and the other sectors.

<table>
<thead>
<tr>
<th>Survey Statistics</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of funds</td>
<td>187</td>
</tr>
<tr>
<td>Total assets ($ billion)</td>
<td>513</td>
</tr>
<tr>
<td>Number of member accounts (million)</td>
<td>20</td>
</tr>
<tr>
<td>Number of directors</td>
<td>1319</td>
</tr>
<tr>
<td>Number of service providers</td>
<td>2575</td>
</tr>
</tbody>
</table>

In the next section, we discuss how different fund types originated and developed historically. We identify two distinct models of pension fund governance: one based on non-profit trustees taking more direct responsibility in portfolio construction for pension beneficiaries in their funds and the other based on for-profit retail trustees passing the portfolio construction task to related service providers in conglomerate structures.

In section three, we show how this interpretation provides an explanation for the observed
differences in pension governance between retail and the other sectors.

In section four, we discuss the existence of multiple conflicts of interest faced by retail funds. Unlike non-retail trustees who should negotiate the optimal fees for investment management services for their funds, retail trustees who have investment managers as executive directors on their boards have impaired incentive to similarly negotiate the fees paid for investment management.

In the final section, we summarise our interpretation of the main findings from the survey data on Australian pension governance, indicating what we need to do to improve the Australian pension market.

The System’s Evolution

Like any living organism, the Australian pension system is an evolving system, driven by changing regulation, financial innovation and changing political climate. Pension governance revealed by the survey data (Sy et al. 2008) on trustee policies and practices is a snapshot of how different pension funds were operating in June 2006, having been created at different times over the history of Australian superannuation. Good or bad governance is a matter of performance relative to board objectives and what is expected of the trustee directors.

Corporate and Public Sector Funds: The Move to Market Funds

Superannuation began in 1862 with the establishment of a defined benefit pension fund for the employees of the Bank of New South Wales (Dunnin, 2008). For the next hundred years, the pension industry remained structurally unchanged, consisting of defined benefit pension funds for some employees in parts of the corporate sector and a few decades later for civil servants in the public sector (ComSuper, 2008). This period coincided with strong trade unions and a strong belief in governments providing social welfare in many parts of the world. The “institutional” model, where trustees have the fiduciary duty to act in the interest of beneficiaries in providing defined benefit pensions was in harmony with the prevailing social ideals. The situation was similar in other parts of the world such as in the U.K. (Myners, 2001).

Major shifts in public policy in the few decades of the Cold War had far-reaching significance for the global financial markets (Greenspan, 2007). Big governments and large budget deficits ceased to be acceptable from the mid 1970s and governments began to curb the power of organised labour unions, starting with Margaret Thatcher in Great Britain. She was joined by Ronald Reagan in the U.S. in the 1980s in a major political shift to free-market capitalism. This period also saw the rise of professional fund managers armed with new theories of investment and financial markets (Mees et al., 2005) and a transition from an employer-dominated defined benefit “institutional” model to a defined contribution “market” model for the pension industry. The Wallis (1997) inquiry into the Australian financial system recognised the changed financial landscape, with increased competition, globalisation, conglomeration and a shift from institutional intermediation to one based on markets.

Over the transition period, pension assets were progressively shifting from “all-in-house” management by corporate and public sector trustees to management by new professional fund managers on a wholesale, commercial basis, through Pooled Superannuation Trusts.
(PST), which hold the assets on behalf of the pension funds as beneficiaries. This trust structure was also used in the 1980s by the same fund managers to offer managed investments for individuals as retail unit trusts in competition with the investment services offered traditionally by stockbrokers. Australian retail unit trusts are the equivalents of U.K. unit trusts or U.S. mutual funds invented in earlier decades (Mees et al., 2005).

**Retail Funds: The Market Model**

Income from distributions and capital gains of retail unit trusts (collective investments) are “passed through” and taxed in the hands of the individuals at their marginal tax rates. When the retail unit trust structure was used to set up retail superannuation trusts starting in late 1980s, tax was then paid at concessional rates by the trusts themselves. When universal superannuation arrived in Australia 1992, this structure provided a vehicle for contract workers, temporary employees, small businesses and the self-employed to save for their own retirement.

These public-offer pension funds, though nominally mutual, have offered their pension products to the public at large, on a commercial basis. Their products were mainly used for wealth accumulation and their trusts were mainly vehicles for holding assets in trust. This was the origin of defined contribution (accumulation) pension funds in the retail sector. The Wallis (1997) inquiry into the Australian financial system generally gave explicit recognition to this connection in promoting efficiency with its recommendation 89: “Regulation of collective investments and public offer superannuation should be harmonised.” These retail pension funds as collective investments are similar to U.S. mutual funds for investors in the 401(k) plans, with the main difference being differences in tax treatments.

Pension in the retail sector represents a “market” model of pension management, where pension investors can more widely shop around for pension products (Dunnin, 2004), in an open competitive market. The implicit assumption of the “market” model is that market discipline from competition will lead to cheaper products with better risk return characteristics that individuals can choose to suit their own circumstances. The pension trustee is, in many cases, mainly a coordinator of administration, custody and investment of pension assets, with substantially reduced fiduciary duty in investment management.

**Industry Funds**

The 1970s and early 1980s were periods of high inflation and the power of unionised labour was in decline. Starting in 1983, the ACTU (Australian Council of Trade Unions) and the then Labour Government (Keating, 2007) agreed on the need to break the nexus between wage increases and inflation. Instead of spending wage increases immediately, possibly fuelling higher inflation, they were to be saved as universal fully vested superannuation. The establishment of industry funds was part of the negotiated remuneration compromise accepted by weakening trade unions. The industry funds were non-profit organisations set up to accept and manage superannuation from wage awards of ordinary workers belonging to defined industry sectors.

Initially, fund membership was restricted to selected industries, but over time, many (now about half) have become public-offer funds accepting employees from all industries. The structure of the trustee boards of industry funds reflects their historical origin, with substantial stakeholder representations. The concept of fiduciary duty to act in the best
interest of beneficiaries under the trust law of the Superannuation Industry (Supervision) Act 1993 (SIS Act), in relation to investment management, was particularly relevant for the industry funds, with its mutuality origin. The trustees typically sought professional advice from asset consultants and outsourced most functions to service providers, including professional investment managers.

By the 1980s it was evident that lifetime employment was becoming rarer in the new era of free-market capitalism, where hiring, firing and job-hopping were more frequent. Most people expected to be employed by several employers in their working lives, and this job mobility made defined benefit plans administratively complex. The preference was for pension portability where workers could take their superannuation benefits with them from one employer to the next. Industry funds were set up from the start as defined contribution (accumulation) funds. The Superannuation Choice legislation in 2005 generally requires employers to allow employees to have freedom of choice in their pension funds. Employees are able to shop for pension products from any number of public-offer funds in a “market” which now has suppliers from an Industry sector as well as a retail sector.

The industry funds and retail funds have very different historical origins and the structural differences are expected to lead to differences-- as observed in trustee practices-- in the fund governance survey (Sy et al., 2008). One example is the task of portfolio construction, which is a complex and potentially time-consuming investment process involving asset allocation and manager selection. Many retail trustees within conglomerate structures have passed the portfolio construction task to related service providers, increasing services and fees for fund members, whereas the portfolio construction task is an integral part of the service provided by other trustees.

Another example is the negotiation of investment management fees implied by governance data on related party service providers. The trustees in industry funds do not appear to have the same level of conflict of interest in negotiating best possible terms for investment management services for their funds, whereas the trustees in retail funds could face opposition from their own colleagues (executive directors) who are often themselves the investment managers to their funds. These aspects are discussed in detail in Section four below.

However, unlike most Industry funds, many retail funds have high recognition due to their associations with reputable brand-name conglomerates and due to their history of easy access by the general public for managed investment products. Conglomerate sizes and the existence of underlying shareholder capital give them a sense of stability and security which are attractive to many investors.

Current Trends

Compared to 1982, when 82% of the memberships were in Australian defined benefit funds (APRA, 2007), at the time of the 2006 survey, 70% of 20 million member accounts were in purely defined contribution funds. Only 2% were in purely defined benefit funds and 28% were in hybrid funds, which offered either defined benefit or defined contribution schemes (See Figure 1).
The hybrid funds of the 2006 survey are likely to be defined benefit public sector funds and corporate funds, where many are being closed or converted to defined contribution funds or transferred to public-offer funds. Australia saw cases where employees lost some or all of their superannuation entitlements when their companies became insolvent (Ferris, 2005). There were also cases with corporate funds invested in company projects or in-house assets, in which employees did not achieve satisfactory rates of return on their pension investments. As the awareness of the risk of under-funding defined benefit liabilities grew, more and more public sector and corporate funds ceased to offer defined benefit plans, which are recognised generally to carry higher financial burdens than defined contribution plans. As of October 2004, even new members of Parliament were no longer eligible to be defined benefit members of the Parliamentary Contributory Superannuation Scheme.

The migration of many smaller corporate funds to the retail sector, and to a lesser extent to the industry sector, was accelerated by the Superannuation Choice legislation in 2005 and also the introduction of Registrable Superannuation Entity (RSE) licensing for pension trustees by June 2006. The costs and increased sophistication associated with new requirements of reporting, investment flexibility and portability favoured larger operations with economies of scale.

Compared to the early years of superannuation, when nearly all assets belong to the public sector or corporate sectors, by June 2006, of the large funds these two sectors combined had only $95 billion which was less than 19% of the total asset of the funds (See Figure 2).
The relative decline of public sector and corporate sectors has also been accompanied by a relative increase in public-offer funds compared to non-public-offer funds, due to greater employment turnover and shifts between the sectors. In the last couple years, a few public sector funds have also become public-offer funds. Between 2001 and 2007 (APRA, 2007), public-offer funds increased from 12% of APRA regulated funds to 43% by number and increased from 58% to 78% by asset value.

In contrast to some countries such as Finland, France, Korea and Norway, where defined benefit pension still dominates (OECD, 2007), the current trend in Australia is for regulated funds to be increasingly dominated by public-offer defined contribution funds in the industry and retail sectors in a competitive “market” model of pension management. Industry funds have non-profit trustees whereas retail funds have for-profit trustees, which are often parts of financial conglomerates.

**Interpreting Sector Differences**

The historical developments of the Australian pension industry described above are important in interpreting many of the statistically significant differences between retail and the other sectors in their pension fund governance policies and practices. We highlight here some of the main findings from the previous report (Sy et al. 2008) for discussion.

**Key Decisions**

Retail pension trustees often see themselves mainly as coordinators of activities such as administration, custody and investment of the fund assets by various related companies in their groups, rather than standalone providers of pension products. Many of the directors are likely to be professional fund managers providing investment and other financial
services to the funds. As retail trustees see themselves as coordinators or organisers for the creation of pension investment products, they tend to leave most inputs to key decisions associated with investment management to the executives, as seen in Table 2.

Table 2: Main Sources of Input to Key Decisions by Sector

<table>
<thead>
<tr>
<th>Key decision</th>
<th>Corporate</th>
<th>Public Sector</th>
<th>Industry</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectives and risk tolerance</td>
<td>Trustee</td>
<td>Consultant</td>
<td>Trustee</td>
<td>Executive</td>
</tr>
<tr>
<td>Strategic asset allocation</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
<tr>
<td>Benchmark design</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
<tr>
<td>Investment manager selection</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
<tr>
<td>Performance monitoring</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
<tr>
<td>Introducing a new fund option</td>
<td>Trustee</td>
<td>Executive</td>
<td>Trustee</td>
<td>Executive</td>
</tr>
<tr>
<td>Default option asset allocation</td>
<td>Trustee</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
<tr>
<td>Asset consultant selection</td>
<td>Trustee</td>
<td>Trustee</td>
<td>Trustee</td>
<td>Executive</td>
</tr>
<tr>
<td>Administrator selection</td>
<td>Trustee</td>
<td>Trustee</td>
<td>Trustee</td>
<td>Trustee</td>
</tr>
<tr>
<td>Foreign exchange hedging policy</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Consultant</td>
<td>Executive</td>
</tr>
</tbody>
</table>

Retail executives provide the main input to all key decisions of retail funds, except for administrator selection where the trustees provide the main input. Trustees in the other sectors see investment managers as service providers to be hired or fired based often on advice from asset consultants. As seen in Table 2, asset consultants have the main input to more than half of the key decisions of corporate, public sector and industry funds, including particularly the input to investment manager selection. The different approaches to decision making can be understood from different historical origins of the funds and they appear appropriate to the different backgrounds of the trustee directors.

Service Providers and Associations

Most service providers (55%) in the survey are investment managers. 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. Corporate funds, being typically smaller funds, often take an approach based on combinations of two or more diversified portfolios, thus reducing the number of service providers used. Larger industry and public sector funds typically use multiple investment managers in separate asset classes, thus increasing the number of service providers used. Retail funds are typically operated by investment managers themselves and hence they mainly only employ non-investment service providers such as administrators and custodians. Excluding 26 retail funds that operate as investment platforms, which use potentially very large numbers of investment managers, the remaining retail funds use an average of 6.8 service providers per fund. We will discuss investment platforms in greater details below.

Retail funds are much more likely to use service providers that are related parties, because up to about 66% of the funds by number and 81% by asset value 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 the survey in 39% of retail funds, 10% 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.

Over 60% 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. As Figure 3 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. This suggests the retail directors are placed in situations of conflict of interest more often directors in other sectors, which we will discuss in the next section.

**Figure 3: Percentages of Board Directors with Primary Employer being a Fund Service Provider or the Current Fund (June 2006)**

<table>
<thead>
<tr>
<th>Primary Employer (%)</th>
<th>Corporate</th>
<th>Public Sector</th>
<th>Industry</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 5</td>
<td>65</td>
<td>60</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>5 - 10</td>
<td>55</td>
<td>50</td>
<td>45</td>
<td>40</td>
</tr>
<tr>
<td>10 - 15</td>
<td>45</td>
<td>40</td>
<td>35</td>
<td>30</td>
</tr>
<tr>
<td>15 - 20</td>
<td>35</td>
<td>30</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td>20 - 25</td>
<td>25</td>
<td>20</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>25 - 30</td>
<td>15</td>
<td>10</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>30 - 35</td>
<td>10</td>
<td>5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>35 - 40</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>40 - 45</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>45 - 50</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>50 - 55</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>55 - 60</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>60 - 65</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Trustee Board Practices**

Consistent with a more limited investment role played by trustee directors in the retail sector, the effort expended by retail directors in running their funds is generally less than those of the other sectors, as seen in Table 3.

**Table 3: Board Practice Distribution by Sector**

<table>
<thead>
<tr>
<th>Board practice</th>
<th>Corporate</th>
<th>Public Sector</th>
<th>Industry</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average number of directors per fund</td>
<td>7.8</td>
<td>7.1</td>
<td>8.8</td>
<td>5</td>
</tr>
<tr>
<td>Average number of board meetings p.a.</td>
<td>6.7</td>
<td>9.1</td>
<td>7.5</td>
<td>9.1</td>
</tr>
<tr>
<td>Average hours per board meeting</td>
<td>3.9</td>
<td>4.4</td>
<td>4.8</td>
<td>2.4</td>
</tr>
<tr>
<td>Average number of subcommittee meetings p.a. per fund</td>
<td>13.1</td>
<td>15.1</td>
<td>14.7</td>
<td>10.7</td>
</tr>
<tr>
<td>Average hours spent p.a. per director outside board meetings</td>
<td>69</td>
<td>123</td>
<td>119</td>
<td>90</td>
</tr>
</tbody>
</table>
Excluding subcommittee meetings, the total time spent ranges from 559 director hours per fund per year for the average retail fund to 1,364 director hours for the average Industry fund (See Figure 4). Retail directors with less investment duties also hold-- on average-- seven other simultaneous directorships, well above the next highest at 2.4 simultaneous directorships held by directors of industry funds. Spending less time by the retail trustees is consistent with a greater reliance on executives (often the same directors) doing their work outside the funds as related service providers. In contrast, non-retail trustees generally spend time either performing similar tasks themselves or reviewing work done by external consultants.

**Figure 4: Average Total Number of Director Hours Spent Per Fund Per Year**

<table>
<thead>
<tr>
<th>Category</th>
<th>Average hours spent per fund per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td></td>
</tr>
<tr>
<td>Public Sector</td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td></td>
</tr>
</tbody>
</table>

**Director Representations**

From the way the trustee structures were set up historically, directors of corporate, public sector and industry funds are largely (59% to 75%) drawn from stakeholders such as employer-sponsors and fund members, and to a lesser extent (3% to 33%) from industrial unions and government. In contrast, only 20% of retail directors are drawn from particular stakeholders or official bodies, a majority (66 %) representing none of those parties .

Public sector funds have 97% 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% and 76%, respectively. However, only 19% of directors of retail funds are appointed from outside the board, with 4% being elected by employer-sponsors and 15% through executive search firms. The remaining appointments are made internally by the board or through personal contacts.
Remuneration: What are the Personal Stakes?

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 are often primary employers of those directors. These payments from service providers, being their primary employers, are well in excess of similar payments to directors in other sectors, whose board positions are not their primary employment.

Directors of corporate, public sector and industry funds are more likely (62% to 73%) to invest their personal superannuation in their own funds than directors of retail funds (21%). When these directors do have personal stakes in their funds, their investments as a percentage of their total superannuation are more substantial (71% to 92%) than those of directors in retail funds (57%). Personal stakes do appear to matter in mutual funds governance in the U.S. (Cremers et al., 2006).

Clearly, retail fund directors have more alternatives than others to invest their personal superannuation, such as to invest in their own corporate funds or to self-manage their own investments (Sy, 2008), as they are typically fund managers. 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.

In conclusion, the governance survey data support the interpretation that many retail pension trustees reduce their direct investment involvement by passing their traditional portfolio construction work to related fund manager executives or to related financial advisors or individual pension investors. This practice can be related to how retail trustees handle their conflicts of interest.

The Mutual Fund Mutation

Many of the observed differences between retail and the other sectors can be interpreted by the differences in approach to investment management. Non-retail pension funds are governed by non-profit trustees who take a broad interpretation of the investment fiduciary duties as outlined in the SIS Act. Retail pension funds are governed by for-profit trustees who oversee fund managers and financial advisors selling pension fund products in an open competitive commercial market. In a similar discussion on mutual funds in America, Bogle (2005) called this difference a mutation from stewardship to salesmanship. What might cause this mutation?

From a traditional corporate governance view, governance of retail pension funds requires the management of multiple conflicts of interest. The traditional corporate governance problem requires the board under the Corporations Act to mediate the conflict of interests between the shareholders as principal and the executives as agent, represented by the left side of the triangle in Figure 5. The traditional pension trustee governance problem requires the board under the SIS Act to act in the best interest of the members as principal in the oversight of the executives as agent, representing by the right side of the triangle in Figure 5.

As well as principal-agent conflicts of interests, there is a new principal-principal conflict of interests for retail pension funds represented by the bottom side of the triangle in Figure 5. Retail trustee directors may be in a situation where they have to decide whether company shareholder profits or whether pension fund member benefits should have priority in the direction of executive action. As Bogle (1999) pointed out for American mutual funds, their directors in trying to serve two masters have tilted the balance of interests in favour of company shareholders.
Whilst company boards and trustee boards of retail pension funds are distinct entities, their historical origins and their typical compositions with significant numbers of overlapping executive directors make the distinction more theoretical than real, particularly in many cases where the shareholders are related entities or a parent company. In practice, the conflicts are “resolved” by the retail trustees treating fund members like clients or consumers in a pension product market, thus possibly diluting the notion of trusteeship in favour of the notion of product manager.

Unlike non-retail trustees who negotiate the best possible terms for investment management services for their funds, retail trustees who often have investment managers as executive directors on their boards have impaired incentive to negotiate best terms for investment management services. Retail pension firms are expected to maximize profit for company shareholders by setting or accepting prices for pension products (including managers’ fees) within a competitive market. Note that this resolution of the multiple conflicts of interest does not imply per se that there is any breach of regulation.

The retail approach to public offer superannuation based on market products is consistent with the recommendations of the Wallis inquiry (1997), which sees a close relationship with collective investments. Indeed, Wallis suggested a resolution of the ambiguities between the role of the trustee and the fund manager by introducing the concept of a single responsible entity, which was adopted in subsequent regulation. However, a number of overlapping legislations in this area, such as the SIS Act 1993, the Financial Services Reform Act 2001 and Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004, has allowed ambiguities to remain in the interpretation (APRA, 2006) of the role of the trustee, which needs further clarification (Parliament of Australia, 2007). The legal issues for Australia and their similarities with legal issues for other countries such as the United States and the United Kingdom have been discussed recently by Donald (2008). We see these issues as originating from a shift of the global financial system to one based largely on market solutions, which are not always fully consistent with earlier systems based largely on institutional solutions.
The differences in governance structure in the Australian pension system may also have parallels with observed differences in manager behaviour between for-profit mutual funds and non-profit pension funds in the U.S. (Del Guercio and Tkac, 2002). The empirical relationships between fund flow and investment performance suggest mutual fund managers operate in fundamentally different environments from those of the pension fund managers.

A Single Practice, Many Benefit

We have shown that the historical origins, including their political, regulatory and financial impacts, of various types of pension funds are important in interpreting the main findings of the recent survey on Australian pension governance. We have identified and highlighted one aspect of trustee practice that may explain the cost differences between retail funds and non-retail funds. Most non-profit trustees perform the investment fiduciary duties including portfolio construction, whereas for-profit trustees within conglomerate structures in the retail sector mostly pass the portfolio construction task either to related executive fund managers or to related financial advisors or to individual pension investors themselves, thus introducing additional costs to the members.

Regardless of the legislations which often define consumer expectations, portfolio construction is a worthwhile task for the trustees to perform in many cases as it saves individual fund members from the costs associated with making complex investment decisions. Every defined contribution fund should have a few low-cost diversified portfolios for most members to choose as their default options, without having to make complex investment decisions, which should only be required to be made by those members who have more complicated financial needs.
References


