



Russell Research

Assessing the 'governance gap'

A survey of the investment decision-making practices of New Zealand superannuation funds

Daniel Mussett
Head of Consulting

November 2011



Executive Summary

In partnership with Workplace Savings NZ, Russell Investments has surveyed the investment governance structures of a representative sample of 29 superannuation schemes.

Based on our findings, and comparisons with the results of similar surveys carried out in the United Kingdom, Australia and the United States, New Zealand superannuation schemes could consider the following measures to address the 'governance gap':

- working toward a more even spread in employer vs employee representation,
- appointing independent trustees or committee members where they do not already feature,
- working to improve response times, for example by use of delegation or pre-determined actions when certain trigger points are met,
- establishing clearer definitions of which single party is ultimately responsible for which decisions,
- enhancing the level of investment experience on investment committees, and
- assessing board performance where this is not already being done.

Introduction

This paper presents the findings of the inaugural New Zealand Investment Governance Survey. The Survey was carried out in partnership with Workplace Savings NZ. It follows similar surveys, studies and roundtables that Russell Investments has carried out in the UK and Europe (2009 and 2011), Australia (2010) and the United States (2011).

The objective of the Survey is to take the pulse of governance and decision-making structures in New Zealand. To facilitate international comparisons, similar questions to those posed in our other surveys were put to superannuation scheme fiduciaries in New Zealand. The Survey covers areas as simple as the make-up of boards of trustees and investment committees through to more complex areas such as the mosaic of delegation structures for various areas of investment decision-making.

Our approach in running the Survey is characterised as follows:

- Russell has taken care to remain within the realm of its expertise. For this reason, we focus on governance as it relates to investment management.
- Rather than imposing our judgement on how things should or could be done, we have taken an objective approach to assessing governance structures. This has involved asking respondents for their own opinions on their structures, processes and effectiveness and reporting back on these.
- To avoid inconsistencies across investor types and with overseas investigations, we have restricted the scope of our study to New Zealand superannuation schemes. Other large investors, such as Crown institutions, non-profit entities and Iwi organisation have not been included.

Governance and management are often confused. A useful definition of what governance really means for corporate entities was set down by R.I. Tricker nearly three decades ago. We feel that this remains equally valid today:

“Management is about running the business; governance is about seeing that it is run properly.”

The remainder of this report is structured as follows:

- Firstly, we summarise the respondents and their characteristics.
- We then present the key features of the compositions of the boards of trustees surveyed.
- Next, we look at key process issues: how assets are managed, how often board meetings occur and what is discussed.

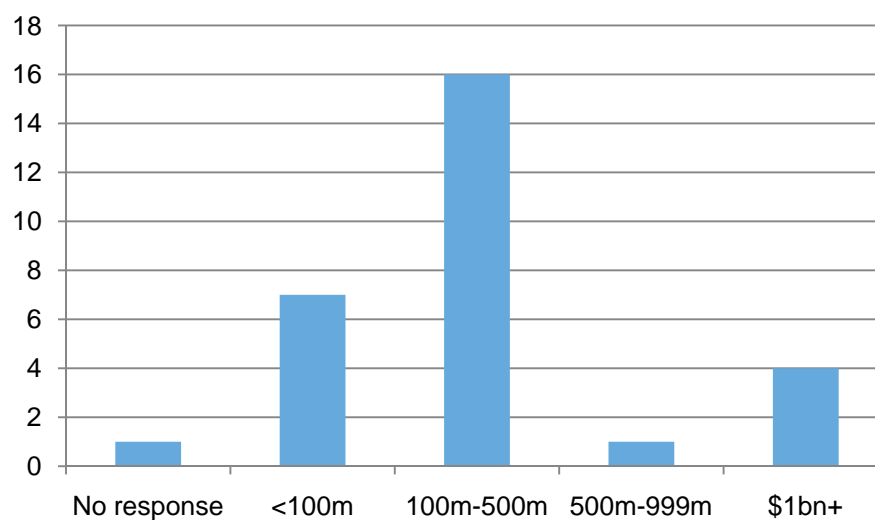
-
- In the fourth section, we cover the use and make-up of investment committees.
 - Delegation structures follow, with a focus on responsibility for key decisions.
 - Subsequently, we report on superannuation schemes' self-ratings of their effectiveness.
 - Finally, we cover whether change is on the horizon for New Zealand superannuation schemes.
 - We would like to extend our sincere thanks to Workplace Savings for their cooperation and support in making this Survey happen.

A view from the top: summary of respondents

Responses from 29 superannuation schemes were received to the Survey. A reasonably representative number of medium-sized schemes (with assets under management of \$100m-500m) took part in the Survey. Responses from all of the very largest standalone schemes (\$1bn or more) were also received. There were few participants from small (less than \$100m) schemes and only one scheme with assets between \$500m and \$1bn responded. However, it is known that there are no standalone schemes in this latter bracket of 'large' schemes, only master trusts, so we were not expecting many responses at all in this range.

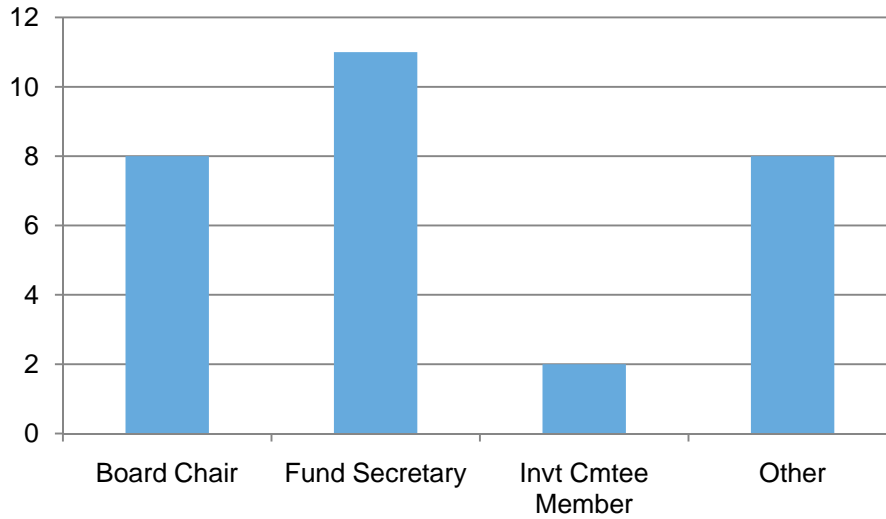
A breakdown of respondent numbers by scheme size is shown below:

Exhibit 1
Respondents by Size of Scheme



We also asked respondents to identify their role within the scheme they represent. As shown below, our Survey can be considered very much a 'view from the top'. The roles grouped in the category 'other' include senior executives or senior administrators of management or sponsoring entities.

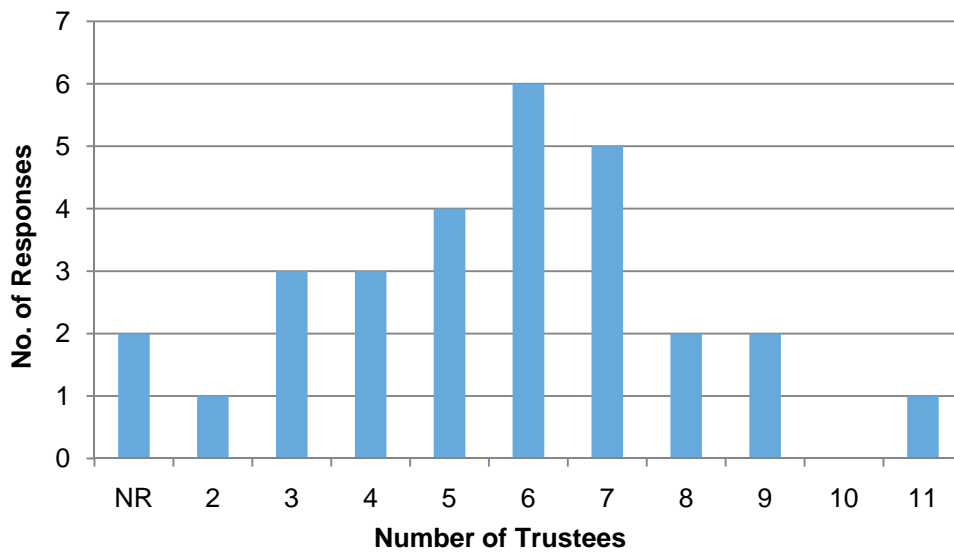
**Exhibit 2
Respondents by Role**



Board composition

We asked our respondents some simple questions on the make-up of their boards of trustees. Firstly, we asked how many trustees were appointed to the boards. The results are shown below.

**Exhibit 3
Investment Management Approach**

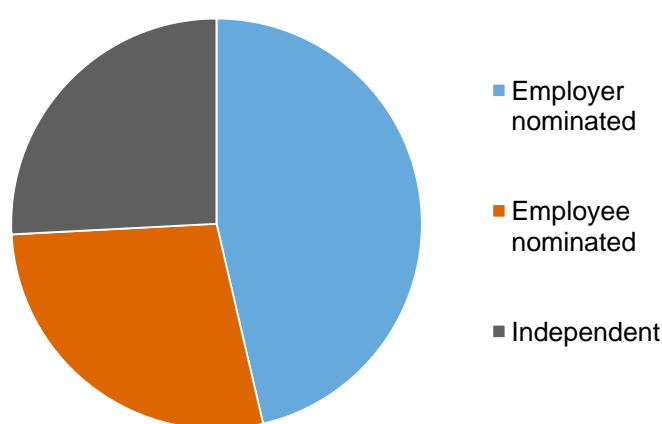


*NR = no response

Typically, boards comprise five to seven trustees. This seems to be a little on the lean side when compared internationally. Further, the distribution is skewed to having fewer rather than more trustees in New Zealand.

We also asked about representation on boards. That is, are trustees employer- or employee-nominated or are they independent representatives? The overall proportions are summarised in the following pie chart:

Exhibit 4
Trustee Representation



This breakdown shows that boards tend to be heavily biased toward employer nominees at the expense of employee nominees. This contrasts quite starkly with Australia, where parity between employer and employee representation is observed and is, in fact a legal requirement, as in Switzerland.

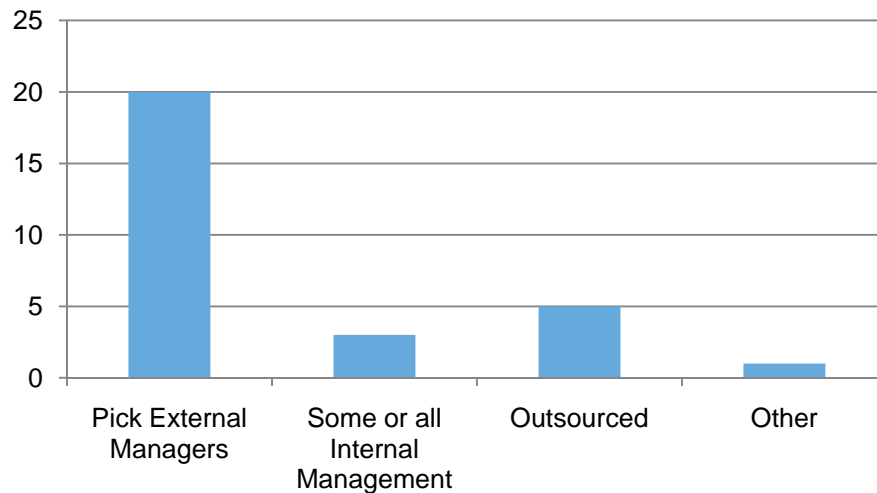
In addition, independent trustees seem to be particularly well represented in New Zealand. 17 of the 29 schemes (59%) indicated that there were independent trustees on their boards. This is more encouraging than in Australia, where the proportion was a more modest 47%.

We were also interested in the level of investment expertise on boards. Just over half (54%) of all trustees of the schemes sampled have a finance or investment background. This is perhaps surprising, but certainly encouraging. Only four (14%) of the schemes have no trustees with a finance or investment background, compared to Australia's 5%.

Process

It is instructive to confirm how schemes are running their investment programmes. By far the preferred approach appears to be to appoint fund managers directly, as illustrated in the following chart:

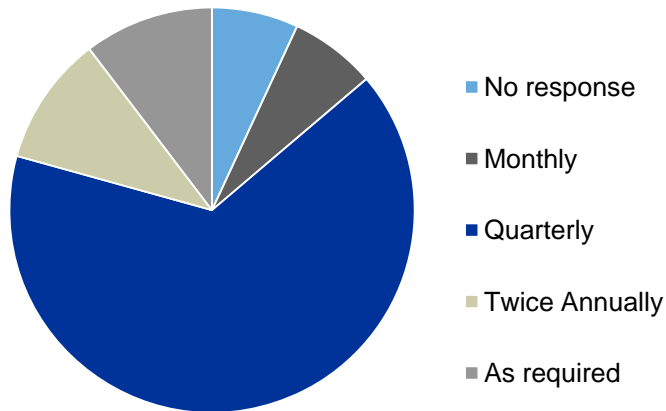
Exhibit 5
Investment Management Approach



These results confirm our understanding that internal management is barely used in New Zealand and that outsourcing is only used to a limited extent (response rate 17%). The latter observation contrasts with the Australian results, where outsourcing is much more prevalent (response rate 36%).

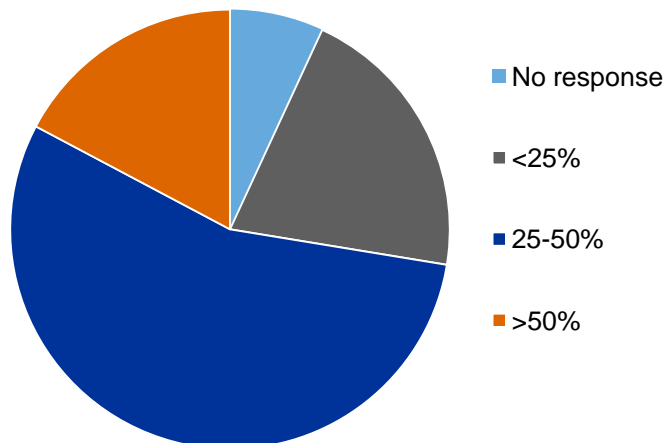
The responses to our question on the frequency of board meetings are shown below. As can be seen, by far the most common frequency is quarterly, (about two-thirds of schemes). Interestingly, this was the same proportion as was observed for boards in our United States survey. In Australia, however, the proportions are quite different: about half of boards meet quarterly and nearly a third indicated they meet monthly.

**Exhibit 6
Meeting Frequency**



We were also interested to know how much of the boards' time at meetings is typically devoted to investment matters. The respondents' estimates are summarised as follows:

**Exhibit 7
Time Spent on Investment**



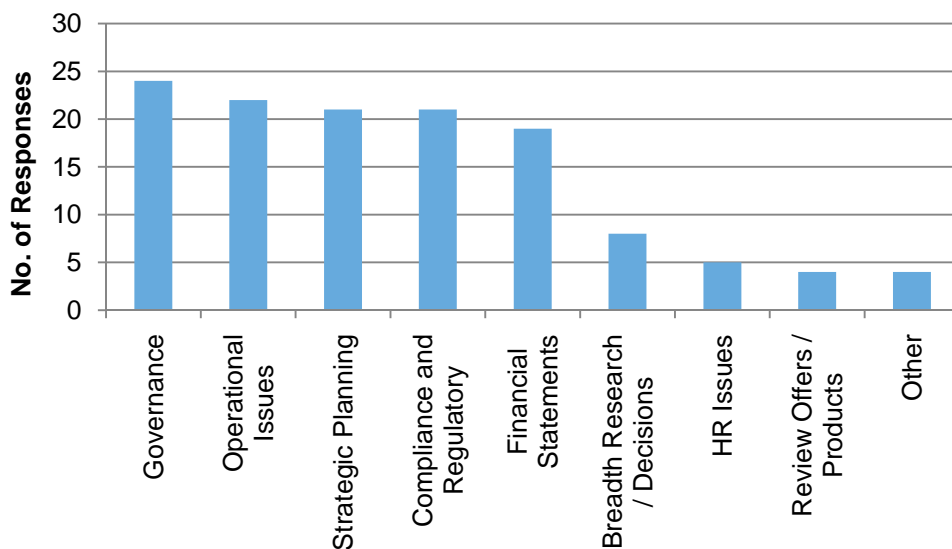
We can see that investment appears to be a priority matter for most boards, with over half devoting 25% to 50% of their time to this topic and about one-sixth more than half of their time. This is promising, given that investment performance is, more often than not, easily the prime determinant of overall financial outcomes for superannuation

schemes. All but one of the respondents thought that their time allocation to investment was about right, with the other indicating that it was too little.

In Australia, boards tend to spend less time on investment. Nearly half indicated they spend less than 25% of their time on investment and very few spend over half their time on it. The same is true in the United Kingdom, with nearly half of boards spending less than quarter of their time on it.

Our final process question enquired as to the items commonly seen on the boards' agendas. The following chart displays these in descending order of frequency:

**Exhibit 8
Board Agenda Items**



Interestingly, governance itself was the most popular agenda item, suggesting that boards are thinking hard about this important topic. The overall pattern shown in this chart corresponds very closely to the results seen in our Australian survey, where human resources issues and offer/product reviews were also seldom on the agenda.

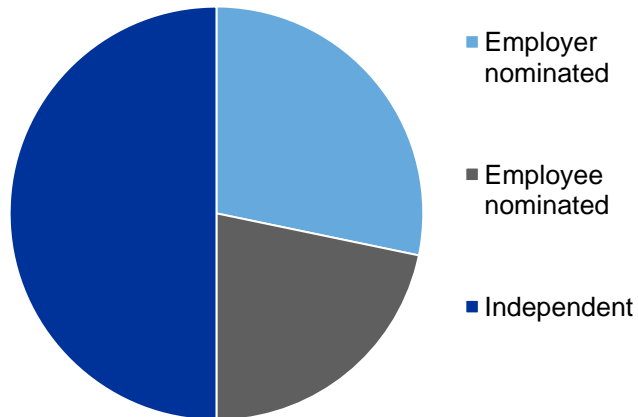
Investment Committees

Under half (45%) of the schemes sampled have an investment committee. This is not too different from the UK result (38%) but certainly at odds with their widespread use in Australia (70%).

The vast majority of investment committees in New Zealand are lean, having between one and four members. This is a similar level of resource as seen in Australia. The average complement in the United Kingdom is four. They are slightly more strongly staffed in the United States, with the average headcount being around five or six.

The representation on investment committees was surveyed, too. The breakdown is shown here:

Exhibit 9
Representation on Investment Committees

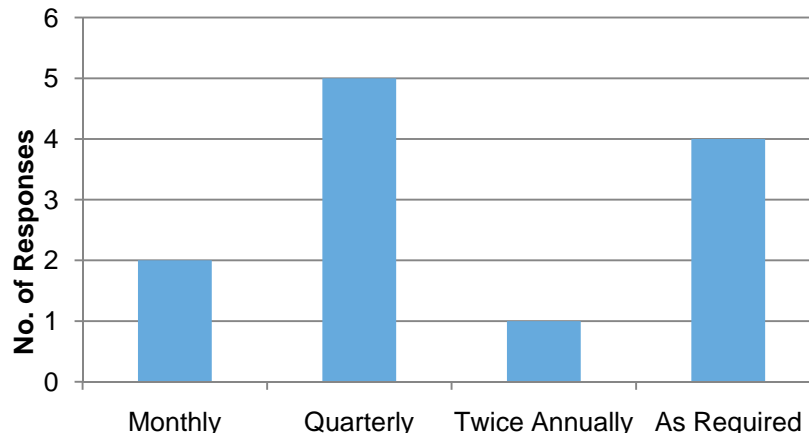


As with boards, employee nominees are not well represented on investment committees. However, it is interesting to note just how strongly independent trustees feature here.

About two-thirds of the members on investment committees have a finance or investment background. This corresponds closely to the proportion seen in the United Kingdom. Australian schemes have an even higher level of 'expertise' at about 80%.

The most common choice for the frequency of investment committee meetings is quarterly, followed by 'as required', as shown below:

Exhibit 10
Frequency of Investment Committee Meetings



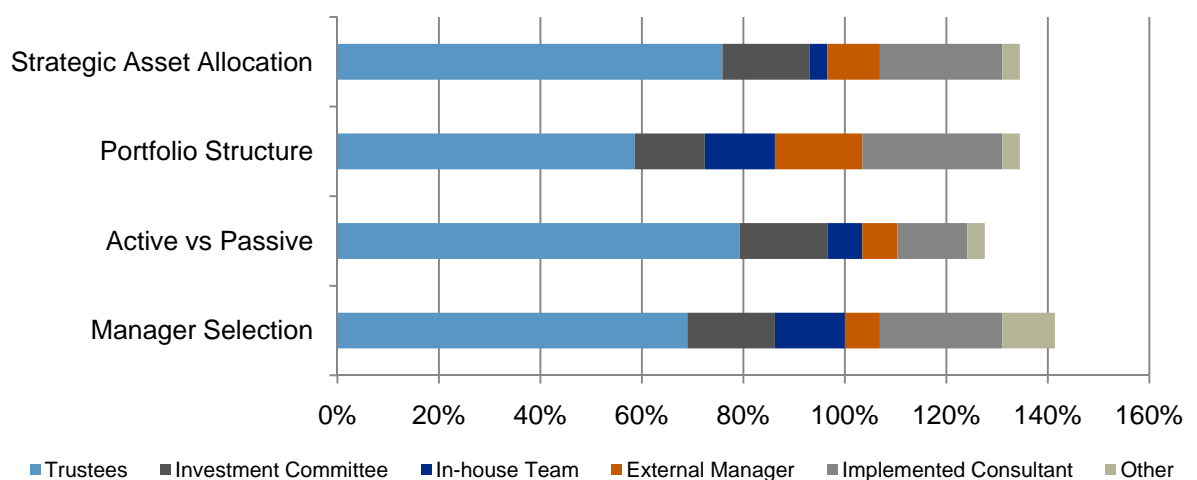
We asked our respondents to rate whether they felt this meeting frequency was sufficient. All rated it as being 'about right'.

Australian investment committees meet significantly more frequently on average, with about half meeting every month.

Delegation structures

We asked our respondents to indicate who was responsible for key investment decisions for their scheme. As was the case in our overseas studies, this identified substantial overlap in responsibility (labelled 'accountability fog' by our Australian colleagues). This is illustrated clearly in the following summary chart:

Exhibit 11
Responsibility for Investment Decisions



The overall indication is that trustees appear to play a dominant role in all of the activities shown. However, the fact that the allocation of responsibility in all cases sums to well over than 100% indicates substantial overlap in responsibility between the different parties.

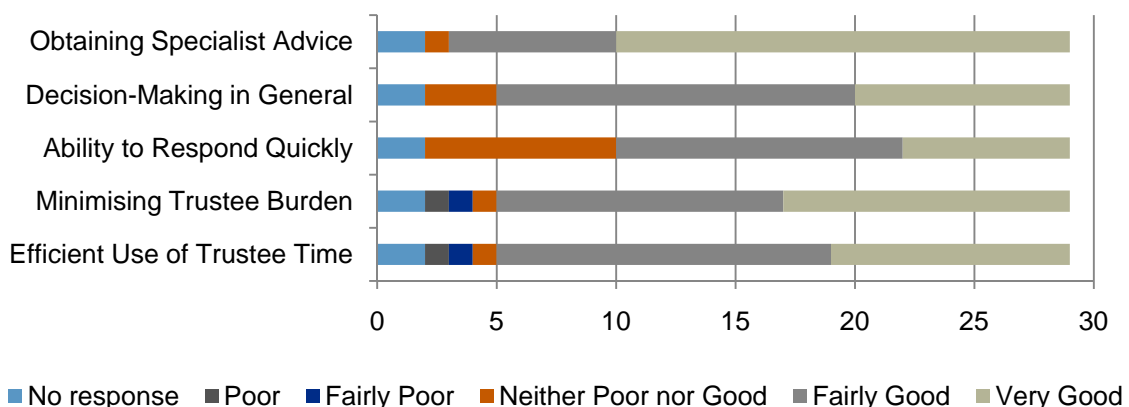
These observations also featured in our United Kingdom and Australian studies. The insight we can draw is also the same: boards could delegate more, with a view to ensuring that there is more clarity in decision-making and seeing that the most appropriate party is assigned responsibility for the decision at hand.

Perceived effectiveness

We asked two questions requiring respondents to give their own assessment of the effectiveness of their structures.

The first related to the effectiveness of key performance measures for the scheme, as summarised in the graphic below:

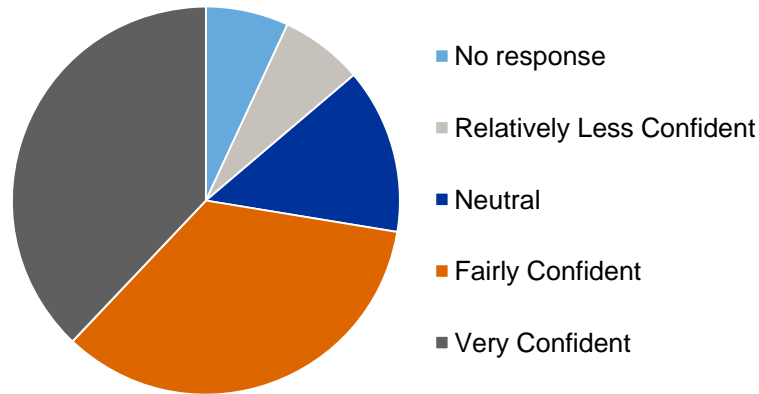
Exhibit 11
Effectives of Key Performance Measures



Overall, respondents rated their effectiveness very well. In particular, schemes appear to have no problem in seeking professional investment advice when necessary. However, there is some evidence of doubt relating to the ability of schemes to respond quickly to new opportunities and situations: about 30% of respondents are not confident in their scheme’s ability to do so. These results closely reflect those seen in our overseas studies.

Our second question canvassed the respondents’ assessments of their confidence that current decision-making processes are suitable to meet future challenges. As shown in the following chart, the answer would appear to broadly show confidence in their abilities to meet the challenges:

Exhibit 12
Confidence Rating for Decision-Making Processes

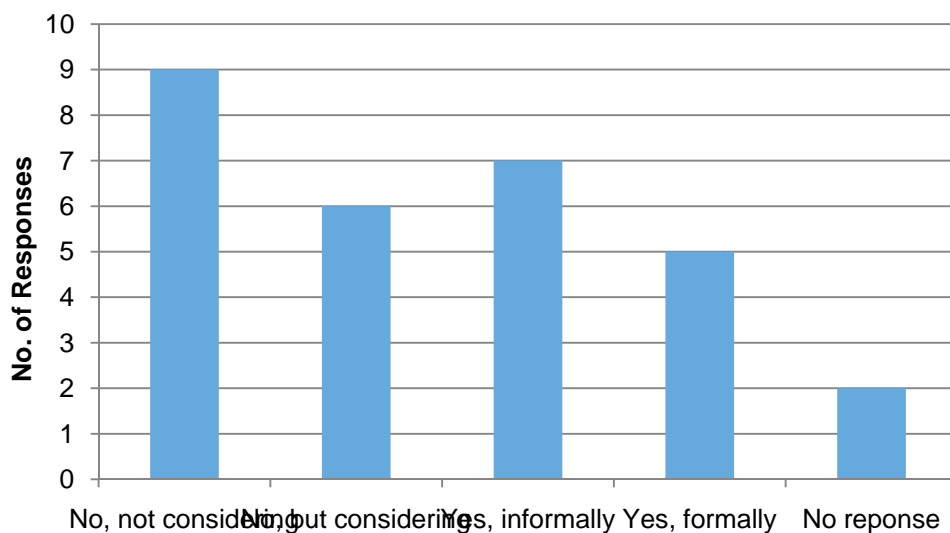


Assessment and change

Our final grouping of questions queried the schemes' plans to assess the performance of their boards of trustees and for changes to their current structures.

The next chart illustrates whether and how schemes are planning to assess board performance.

Exhibit 13
Plans to Assess Board Performance?



The most common response was an indication that such assessments are not currently done and nor are there plans in place to do so. However, a clear majority either do this already or are considering doing it.

As noted in our UK paper, *Aspects of Good Investment Governance* (February 2011), the boards of UK public listed companies have introduced triennial self-evaluation with an external evaluator. It makes sense for the boards of superannuation schemes to consider doing this, too. As noted in the same paper, trustees do not and need not feel that self-assessment is the same as self-blame. Rather, it is an opportunity for improving existing practices and to foster ownership of these practices, particularly for fiduciaries who are new to their board or organisation.

We also enquired as to whether changes to decision-making practices were envisaged or not. The vast majority (22) replied in the negative, although five schemes are considering this. These five are considering fundamental changes to their governance (2), setting up an investment committee (1), outsourcing asset management (1), or other steps (2).

Conclusion

The key findings of our Survey can be summarised as follows:

- Governance is firmly on the agenda of New Zealand superannuation schemes.
- The preferred approach to managing the investment programme is to select external fund managers.
- Employees do not appear to be well represented on trustee boards or investment committees.
- The use of investment committees is not the norm in New Zealand, contrasting with their widespread use in Australia.
- Most New Zealand schemes are already using independent trustees although here is currently no requirement to do so. They are especially well-represented on investment committees. This put New Zealand ahead of Australia, where the use of independent trustees has been clearly advocated in the Cooper Review.
- Finance and investment skill appears to be fairly well-represented on trustee boards and investment committees.
- As in the United Kingdom and in Australia, there is evidence of a lack of clarity in accountability for key aspects of decision-making.
- Schemes rate their structures well in terms of their effectiveness and readiness to meet future challenges. The least confidence was expressed with regard to the ability to react quickly to changing circumstances and opportunities.
- Very few schemes are planning changes to their current decision making structures or governance practices

Some suggestions for improving investment governance fall neatly out of our analysis. New Zealand superannuation schemes could consider the following measures:

- working toward a more even spread in employer vs employee representation,
- appointing independent trustees or committee members where they do not already feature,
- working to improve response times, for example by use of delegation or pre-determined actions when certain trigger points are met,
- establishing clearer definitions of which single party is ultimately responsible for which decisions,
- enhancing the level of investment experience on investment committees, and
- assessing board performance where this is not already being done.

Related Reading

D. Don Ezra, S. Kelly-Scholte, S Kothare (2011) Aspects of good investment governance: Lessons from recent investor roundtables, Russell Investments

D. Don Ezra (2010), Investment governance: A pragmatic update, Russell Investments

Kelly-Scholte, Sorca and Shashank Kothare (2009), *Mind the 'Governance Gap'*, Russell Investments

K. Ambachtsheer (2006), *How much is good governance worth?*, The Ambachtsheer Letter #245, June 2006

D. Don Ezra (1999), Excellence in UK Pension Fund Management – a perspective on current practices, Russell London Monograph 11

John H. Ilkiw (1997), *The importance of being prudent*, The Portable Pension Fiduciary: a handbook for better pension fund management

The information contained in this publication was prepared by Russell Investment Group Ltd on the basis of information available at the time of preparation. This publication provides general information only and should not be relied upon in making an investment decision. Investors should seek professional financial advice from an authorised financial adviser which takes into account their personal circumstances before making an investment decision. In particular, the information contained in this publication is not personalised financial advice for the purposes of the Financial Advisers Act 2008 (NZ). Russell Investment Management Ltd and its directors will not be liable (to the maximum extent permitted by law) for any loss or damage arising as a result of reliance being placed on any of the information contained in this publication. None of Russell Investment Group Ltd, Russell Investment Management Ltd, any member of the Russell Group, their directors or any other person guarantees the investments or the returns on the investments in the Russell Funds Investment Programme. The Product Disclosure Statements or the Information Memorandum for the Russell Funds (as applicable) are available by contacting Russell Investment Group on 0800 357 6633. Copyright 2011 Russell Investment Group Ltd. All rights reserved.