ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world’s leading initiative on responsible investment. The PRI represents nearly 1,500 signatories globally, managing $60 trillion. Australia is home to the PRI’s fourth largest signatory base, after the US, UK and France. There are 118 Australian signatories, including 34 asset owners.

The six Principles for Responsible Investment offer a menu of possible actions for incorporating environmental, social and governance (ESG) issues into investment practices. They were developed by investors and are supported by the UN. For more information, see www.unpri.org.

CONSULTATION RESPONSE

The PRI’s contribution to this review centres on the need to address sustainability and responsible investment considerations in any development of superannuation fund governance in Australia. We make three recommendations in this submission. The Fraser review, as part of the recommendations for any Not-for-Profit fund governance code, should:

- seek to ensure that pursuing board capacity, competence and professionalism on ESG integration is a core element of any ensuing code.
- address the benefits of aligned guidance from Australia’s relevant financial regulators on the role of ESG in good fund governance.
- should address measures ensuring that trustee boards improve their performance through greater ‘inherent’ and ‘acquired’ diversity.

The PRI is supportive of industry-wide codes that embody the principles of good governance. We note that the intent of this review is to develop a binding code for all superannuation funds who are members of the Australian Institute of Superannuation Trustees (AIST) and Industry Super Australia (ISA). We hope the adoption of such a code will lead the way for all funds, with an eventual expansion to all superannuation funds.
We note that AIST established a Fund Governance framework, which was last issued in 2014. We believe that this framework is a useful starting point, that sets out many of the principles of good governance, including a section on the inclusion of environmental, social and governance (ESG) factors into the investment process (as set out below).

**AIST Fund Governance framework: 7.1 ESG risks**

“Environmental, social and corporate governance (ESG) risks are important risks for trustees to consider as part of their investment processes. None of these risks, of course, should be considered in isolation, but rather, integrated with financial risk considerations. Trustees need to consider the environmental and social impacts of their own operational activities and perceptions of their own fund governance practices.

Disclosure of the trustee’s approach to ESG risks, both through its investment portfolio, and through its own operations, should demonstrate that trustees have a comprehensive approach to addressing ESG factors. We encourage funds to disclose to members:

- Relevant environmental, social and corporate governance policies incorporated in the fund’s investment policies;
- The governance framework and strategies for managing corporate governance, environmental and social issues at the trustee level; and
- The fund’s proxy voting policies and any material voting behaviour. Trustee directors should consider independent third party assurance of ESG reports”

Consistent with section 7.1 of the AIST Fund Governance Framework, the PRI believes that good superannuation fund governance requires that trustee boards have the expertise and resources to fully integrate sustainability considerations in the management of their members’ assets.

**FIDUCIARY DUTY AND GOOD GOVERNANCE**

The PRI examined the issues of board capacity, competence and professionalism in its recently published report, *Fiduciary Duty in the 21st Century*. The central finding of the report, which examined fiduciary practice in eight countries, was that:

“Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty.”

The report found that fiduciary duty requires boards to be able to show that they have identified the relevant risks to their investments, including those arising from ESG issues, that they have put appropriate strategies in place to manage these risks and that they have overseen and monitored the actions of those charged with managing these risks (e.g. investment managers).

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Recommendation 1: The Fraser review, as part of the recommendations for any Not-for-Profit fund governance code, should seek to ensure that pursuing board capacity, competence and professionalism on ESG integration is a core element of any ensuing code.

Implementing voluntary codes and complementary regulation

*Fiduciary Duty in the 21st Century* also found that industry codes, often developed in the form of Stewardship codes (such as in the UK and Japan), are most effective in respect to ESG considerations when they align with, or are reinforced by, requirements in underlying investment legislation and policy instruments.

The report made the following specific recommendations for Australian financial regulators:

- The Australian Prudential Regulation Authority (APRA) should clarify that fiduciary duty requires asset owners to pay attention to long-term factors (including ESG factors) in their decision-making, and in the decision-making of their agents.
- Australian regulators should clarify that responsible investment includes ESG integration, engagement, voting and public policy engagement.

Although these recommendations were made before the Fraser review was announced, the PRI’s experience is that stewardship codes or voluntary industry codes can require reinforcement in regulatory instruments to ensure a level playing field for industry professionals.

Recommendation 2: The Fraser Review, as part of the recommendations for any Not-for-Profit fund governance code, should address the benefits of aligned guidance from Australia’s relevant financial regulators on the role of ESG in good fund governance.

**TRUSTEE BOARD CAPACITY ON ESG**

Superannuation funds that are most proactive and progressive on responsible investment tend to be those where the board has detailed knowledge and expertise of ESG issues.

This is particularly important in Australia, where superannuation funds tend to be heavily weighted towards domestic equities, resulting in them having large exposure to energy, mining and financials – sectors in which ESG considerations are causing significant changes.

Asset owners are paying increasing attention to ESG issues in their investment processes, demonstrated in part by their participation in:

- the Australian Council of Superannuation Investors (ACSI) which develops and supports the implementation of guidelines for superannuation funds on ESG issues;
- the ASX Corporate Governance Council, which recently updated ESG guidance for companies to use in their market disclosures;
■ developing the Financial Service Council’s (FSC) standards on voting disclosure and ESG risk reporting;
■ developing and implementing Investor Group on Climate Change guidance on integrating climate risks and opportunities into investment decision-making.

The strengthening of trustee competence requirements to “prudent, professional superannuation trustee” (in Section 52(2)(b) of the SIS ACT) supports the case for asset owners to focus on ESG issues.

The PRI recognises that there is no one-size-fits-all approach to investment governance. Best practice varies based on governance challenges, including the conflicts of interest that must be eliminated or managed.

Equal representation models can support superannuation funds in meeting their sustainability objectives: employee and employer representatives are supported where required by independents (in particular independents or other directors who offer expertise on ESG issues), and can hold investment consultants and managers to account on ESG considerations. We note that in jurisdictions with industry-oriented pension funds, equal representation governance models are common. Funds governed by equal representation have been among the most innovative and practical in the area of responsible and sustainable investment, including funds in Australia, the Netherlands and the Nordic region.

In September 2015, the PRI commissioned YouGov to survey over 8,000 pension plan beneficiaries across seven countries: Australia, Brazil, France, Japan, South Africa, UK and US. The survey found that beneficiaries around the world, in particular young people, are taking account of issues such as how a company manages climate change and whether companies are exploiting tax loopholes. With these expectations from beneficiaries, it is becoming increasingly important that trustees can respond in an informed way to companies’ management of ESG risks and opportunities.

Partly as a result of their relationship with workforces, superannuation funds governed by equal representation boards have been responsive, innovative, and in particular, leaders, in the area of responsible investment. Changes to the governance structure must build on, and not undermine, this leadership.

DIVERSITY ON TRUSTEE BOARDS

Whilst the superannuation sector leads corporate Australia on the issue of women on boards, we believe that more can be done to address gender diversity by including clear guidelines within an industry code. There is extensive evidence about the enhanced performance of diverse company boards.

The findings are also relevant to trustee boards, for example:
A recent study by Grant Thornton, entitled "Women in business: the value of diversity," finds that companies in the US, UK and India that have all-male executive teams are sacrificing US$655 billion in profits and that in the US and UK, replacing all-male teams with diverse ones would boost GDP by around 3%.

The Centre for Talent Innovation found that publicly traded companies (in the US) with two-dimensional diversity, i.e. “inherent diversity”– such as gender and race – combined with “acquired diversity” – such as global experience and language skills, were 45% more likely than those without to have expanded market share in the past year, and 70% more likely to have captured a new market.

Oxford Economics produces The Global Diversity Report, which is a global index of employee diversity covering gender, place of birth, age, working hours, language, education and sectoral distribution. There is a positive correlation between company ranking in this report and the World Economic Forum’s Global Competitiveness Index.

The Credit Suisse Research Institute in 2012 reviewed 2,360 global companies and found that those with female directors outperformed those without in ROE, average growth, and price/book value multiples. Companies with at least one female director had better share price performance than those with none.

Drawing on the extensive evidence for improved board performance where greater diversity exists the PRI makes the following recommendation:

**Recommendation 3: The Fraser review, as part of the recommendations for any Not-for-Profit fund governance code, should address measures ensuring that trustee boards enhance their performance through greater ‘inherent’ and ‘acquired’ diversity.**

**CONCLUSION**

The PRI has experience of investment governance and regulation relevant to the Fraser Review in a number of investment markets internationally. The PRI offers its expertise to support the Fraser Review in strengthening governance of superannuation funds, in particular, to ensure integration of ESG issues into governance practices.

**CONTACT**

Fiona Reynolds, Managing Director, PRI
Fiona.Reynolds@unpri.org

Nathan Fabian, Director of Policy and Research, PRI
nathan.fabian@unpri.org