

GARDS Update

June 2016



GARDS: Frontier's Governance Advice, Research, Decision and Strategy team.

GARDS Update - Member Focus in Focus

Improved Transparency in Superannuation – Superannuation Legislation Amendment (Transparency Measures) Bill 2016

The proposed Bill has been deferred by the Senate and as a result the effective dates have also been deferred. The proposed effective date for MySuper Options is now 1 July 2017, with an additional three months permitted for qualifying Choice Options now being required by 1 October 2017 (the original proposed effective date was 1 July 2016 for both MySuper Options and Choice Options).

In relation to the Portfolio Holdings Disclosure (PHD) regime, the first six monthly reporting day will now be 31 December 2017 (previously 31 December 2016). Some relief from the information requirement has been proposed. Information relating to the first investment in non-associated entities must be disclosed, however “look through” information about investments held through non-associated entities will not be required.

There are a number of exclusions proposed to reduce the compliance burden on RSEs where the benefit of disclosure for members and their employers is limited. The following is a list of some of the proposed exclusions.

- Investments that are not material for the investment option.
- Up to 5% of attributable assets for each investment option. RSEs must be able to prove it is commercially sensitive and/or detrimental to the interests of the members of the fund.
- Defined benefit funds.
- Defined benefit element of a hybrid fund but not the accumulation element.
- Legacy products which are closed to new members for at least five years.
- “Other” types of investments that, through disclosure, offer no benefit or are detrimental to the interests of the fund and its members.

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Enhanced Disclosure Regime – Regulatory Guide 97 (RG 97)

In November 2015, ASIC released the updated Regulatory Guide 97 – Disclosing fees and costs in PDSs and periodic statements (RG 97) which amends the rules for disclosing fees and costs. The purpose of the amendments is to provide clarity and promote accuracy and consistency across the industry in the disclosure of fees and costs, and it aims to improve comparability between products for retail clients.

The following key changes have been made to Schedule 10 of the Corporations Act to align with section 29V of the Superannuation Industry (Supervision) Act 1993 (SIS Act) for superannuation products as a result.

- Investment Fee.
- Advice Fee.
- Indirect Cost (amended).

Perhaps the most contentious is the amended description of “indirect cost” which now captures any amount that is not already disclosed as a fee or cost, and directly or indirectly reduces the return of the product.

Disclosure of fees and costs should be based on the actual amounts paid in the previous financial year for existing products, or based on a reasonable estimate for the current year in the case of new products. At the end of each financial year, a fund should consider whether its fee and cost disclosure needs to be updated to ensure the PDS is up to date. If any difference is not materially adverse from the investors’ perspective, the update may be provided through the fund’s website (provided the conditions of ASIC CO 03/237 are met).

The enhanced fee disclosure is mandatory for any PDS provided on or after 1 February 2017 and periodic statements provided on or after 1 January 2018.



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A Global Perspective on Responsible Investing

Responsible investing has evolved in recent years and is starting to receive more attention as more funds and investment managers alike find new ways to integrate environmental, social and governance (ESG) considerations with investment considerations. Member activism and greater general awareness has helped push the matter into the spotlight further in recent times. This is a global consideration and our Global Investment Research Alliance (GIRA) Partners, US based Segal RogersCasey (SRC) and UK based Lane Clark Peacock (LCP), share their observations to give a perspective of responsible investing in the US and in the UK.

LCP has noted that they are starting to see interest from clients in fossil fuel exposure, although the main focus is on understanding the managers' approach to managing the associated risks rather than divestment. LCP has been researching "low carbon" products although "fossil free" products are also available. Investors in the UK can also choose to invest in specialist products that invest in companies positioned to benefit from sustainability trends such as renewable energy.

SRC has noted that they are starting to see interest from clients in carbon and fossil fuel reduction and there has been some recent interest in excluding firearms makers.

Socially responsible investing (SRI) screening has been around for a long time in the US and most managers can easily construct a portfolio to suit the individual needs of the client. A number of US investment managers offering specialist products seem to be well versed in governance considerations but less so in the social and environmental side.

Regulation in Ontario, Canada has mandated public and private funds in the Ontario province to disclose whether ESG factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated. The regulation became effective on 1 January 2016 and is the first such rule in Canada. These provisions are similar to those already in place in the UK, France, Germany, Sweden and Belgium.

The acceptance of ESG and responsible investing depends on the region and the type of fund. On a global scale it is evident that the majority of higher education funds are very transparent about their stance on ESG which is driven by student activism, academic involvement and board pressure. Larger public funds are typically the leaders in ESG investing due to media attention, board pressures and scale.

We expect ESG focused products to expand as the market develops with the availability of reliable data to quantitatively measure outcomes and intermediaries being established to facilitate effective transactions.



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Board Diversity

What makes a great board is a hotly debated topic at the moment – gender and composition, cognitive abilities and independence are commonly argued as the key traits of a successful board from an overall skills perspective. Board diversity, in particular gender composition, is becoming an increasingly important consideration for institutional investors and a number of global asset owners are promoting a target of 30% female directors on their boards, as well as for listed companies in which they invest. Academic research in management and psychology shows that groups with a diverse composition tend to make better decisions and are more innovative. Boards that lack diversity have experienced more governance-related controversies than the average company, according to MSCI research.

European countries are currently leading the charge with greater female representation on boards, with 40.1% of total board seats being held by women in Norway, followed by 33.7% in Sweden and 33.5% in France. This is compared to an overall global representation of 15.0% of women holding directorships on boards. Additionally, while it is reported that 73.5% of companies globally have at least one female director, this number falls to just 20.1% of companies that have at least three females who hold director roles.

Figures 1 and 2 below provide an example of the current gender balance on Trustee Boards of Australian superannuation funds, based on data from APRA.

Figure 1: Gender Balance on Individual Trustee Boards

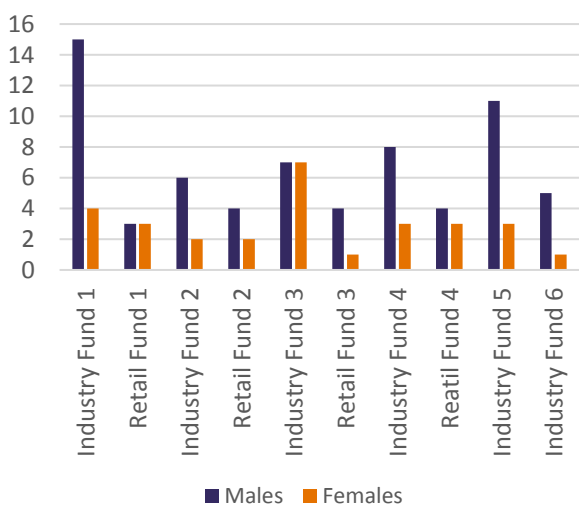
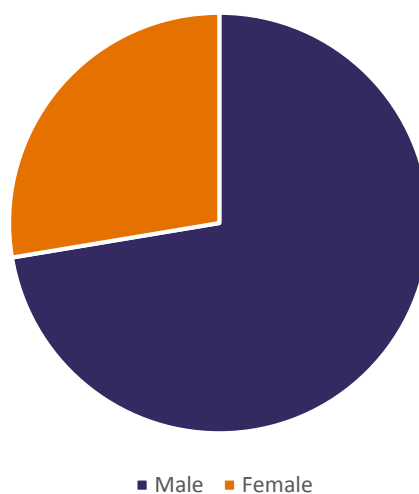


Figure 2: Gender Representation on Trustee Boards (Industry Average)



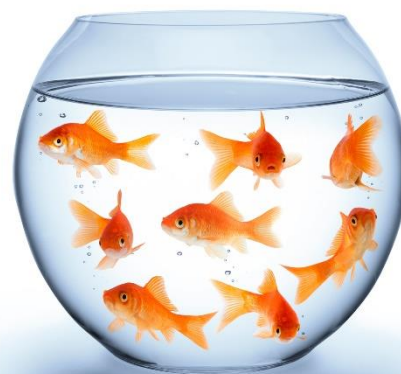
Source: APRA

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In our opinion, the board diversity challenge stretches much deeper than the gender balance. While we think having a good balance of females and males on boards is likely to be extremely additive to all companies, we also think that diversity on boards should stretch to other areas such as education backgrounds, previous experience, age, race/nationality and cognitive styles. To combat groupthink, companies should value the contrarian in the room, that is, someone who can challenge and simply think in a different style to others in the room.

The ideal board is one with a sense of fiduciary awareness, with a real focus on stakeholder outcomes but also with the skills, collectively, to allow them to be effective and efficient. Boards should take a forward looking approach to new hires and consider what skills they will need in three, five and ten years.

"I think that trustee boards need to recognise where they are lacking in skills or knowledge and seek to supplement those in their appointment process" – Penny Green, Independent Trustee, UK¹.



1. IPE Magazine July/August 2015

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Timeline of key industry developments

Proposal/Change	Summary of change	Proposed Timeline
Product Dashboards and Improved Transparency <ul style="list-style-type: none"> Amended Reporting Standard SRS 700.0 Product Dashboard (SRS 700.0) Draft Reporting Standard SRS 702.1 Investment Performance (Non-MySuper Investment Options) (SRS 702.1) 	Amend existing product dashboard requirements for MySuper products and put into effect requirements for product dashboards for the 10 largest qualifying choice investment options	Proposed effective date: <ul style="list-style-type: none"> 1 July 2017 (MySuper Options) 1 October 2017 (Choice Options) (previously 1 July 2016 for both MySuper Options and Choice Options)
Portfolio Holdings Disclosure (PHD) Regime <ul style="list-style-type: none"> Superannuation Legislation Amendment (Transparency Measures) Bill 2016 	Publish, for each investment options, information relating to the first investment in non-associated entities. "Look through" information about investments held through non-associated entities will no longer be required	The proposed first six monthly reporting date: 31 December 2017 (previously 31 December 2016)
Choice of Fund <ul style="list-style-type: none"> Superannuation Legislation Amendment (Choice of Fund) Bill 2016 	New employees are required to receive a standard choice form and existing employees will be able to request a form and the employer will be required to act on such a request in accordance with the choice rules	New workplace determinations or enterprise agreements that are made from 1 July 2016
Accounting Standard AASB1056 will replace AA25	Changes to preparation, presentation and calculation some aspects of the financial statements	1 July 2016
Disclosure Requirements <ul style="list-style-type: none"> Regulatory Guide 97 – Disclosing fees and costs in PDSs and periodic statements (RG 97) 	Changes to the disclosure of fees and costs to improve accuracy and consistency across the industry	Mandatory for any PDS provided on or after 1 February 2017 and periodic statements provided on or after 1 January 2018
Board Governance <ul style="list-style-type: none"> Prudential Standard SPS 510 Governance Prudential Practice Guide SPG 510 Governance 	Formal structure and documentation of governance/board arrangements, APRA's view is that it is up to the RSE to determine the most appropriate method but it must be formal and thoroughly considered	Revised governance arrangements released in December 2015 – expected to be made final in early 2016 *No further updates as at 20 June 2016



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