



ASIC
Australian Securities &
Investments Commission

Governance of responsible entities

January 2022

This presentation sets out the key findings, observations and considerations for responsible entities and their boards arising from ASIC's review of specific aspects of the governance practices of 10 large responsible entities.



About our review

The managed funds sector is an important part of the Australian financial services industry. As at 30 June 2021, approximately \$1.514 trillion¹ was invested in registered schemes. There were 3,616 registered schemes as at 30 June 2021².

Given the size and importance of the managed funds sector and the potential for conflicts of interest (including at the board level), we decided it was timely to review some aspects of responsible entity governance. Our review was designed to gain early insights into governance practices at some of the larger responsible entities.

We reviewed specific aspects of the governance practices of 10 large responsible entities. We selected the 10 responsible entities based on the total assets under management and the operating models used. Our selection was not based on risk or any ASIC concerns about the responsible entities.

We collected information and documents from the 10 responsible entities by reference to the financial year ended 30 June 2020 (the relevant period).

The graphs on the next slide set out key information about the 10 responsible entities surveyed. As at 30 June 2021, the 10 responsible entities represented 38.8% (\$588 billion) of assets under management in registered schemes³. The 10 responsible entities operated 35.2% (1,273 registered schemes) of all registered schemes as at 30 June 2021.

¹ The figure of \$1.514 trillion is derived from ASIC's Industry Funds Metrics data for the 2020–21 financial year. The total amount invested excludes assets that are cross-invested in another scheme operated by the same responsible entity.

² The figure of 3,616 registered schemes is provided by ASIC's Financial Services Licensing system.

³ The figure of \$588 billion is derived from ASIC's Industry Funds Metrics data for the 2020–21 financial year. The total amount invested excludes assets that are cross-invested in another scheme operated by the same responsible entity.

Key characteristics of the 10 responsible entities

Figure 1: About the 10 responsible entities in our review (as at 30 June 2020)

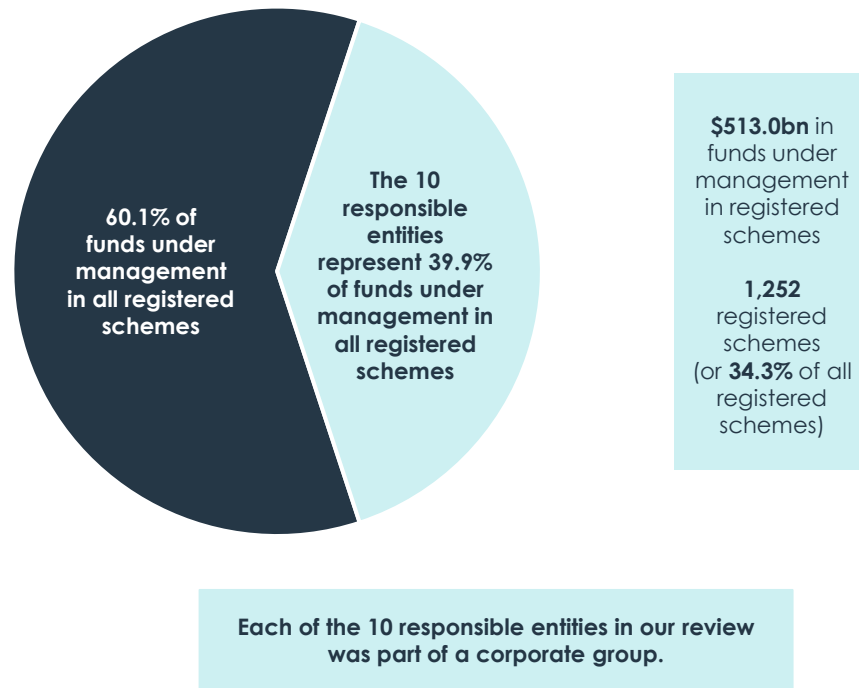
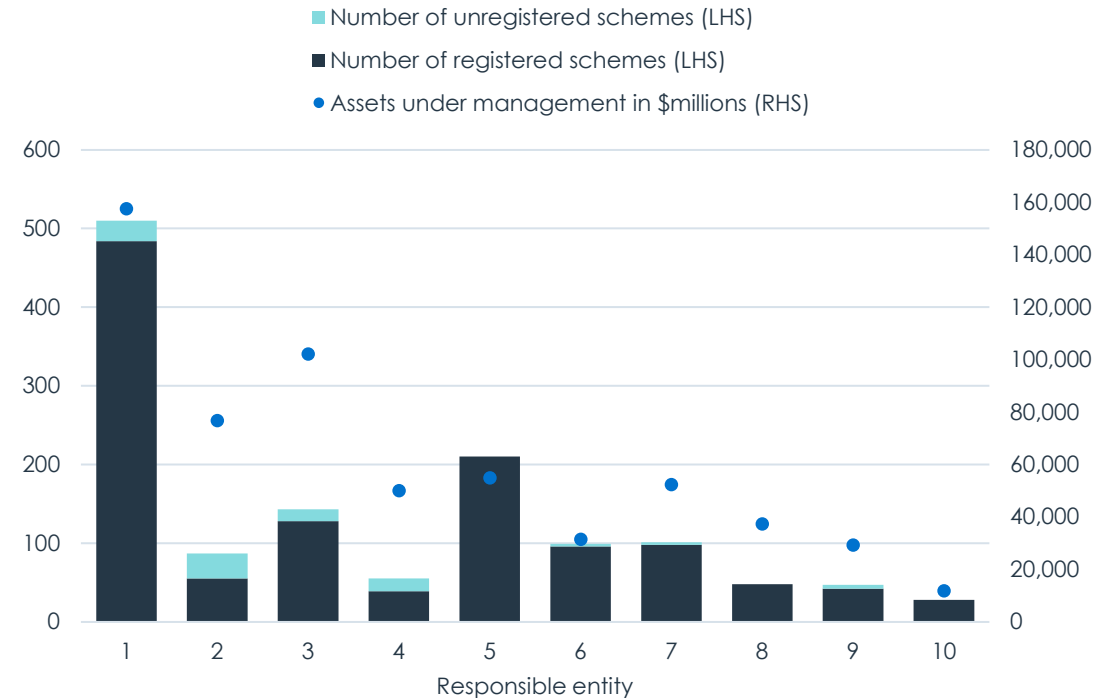


Figure 2: Size of the 10 responsible entities in our review (as at 30 June 2020)





What we found

1. Five of the 10 responsible entity boards had a majority of executive directors and one board had an equal number of executive and non-executive directors. Six boards had a majority of non-independent directors.
2. The average length of tenure for a director across the 10 responsible entities was approximately 4.5 years.
3. A director held on average 6.7 additional roles that were external to the responsible entity, including directorships and committee positions at other entities (including entities in the same corporate group as the responsible entity). The average estimated time commitment for a director's external roles was 10.1 days per quarter.
4. Eight of the responsible entities obtained all of their staff resources from other entities in the same corporate group. These eight responsible entities did not employ their own staff.
5. The responsible entities had documented delegation and reporting frameworks.
6. The number of outsourced service providers the responsible entities engaged during the relevant period ranged from five to over 150. The responsible entities had arrangements to monitor outsourced service providers.
7. The responsible entities demonstrated an awareness of managing conflicts of interest. This included the directors routinely declaring conflicts at board meetings. Where a director had a conflict of interest in a matter before the board, there was a tendency for the conflicted director to be the party who decided the extent to which they should not be involved in the matter, as distinct from an independent arbiter (e.g. the non-conflicted directors or chair) making that decision. Directors should consider whether they have a 'material personal interest' in a matter under s195.

Board composition

Overview of board composition

The boards of the 10 responsible entities we reviewed had varied compositions in terms of the division of executive directors and non-executive directors, and whether the directors were independent of the responsible entity. We relied on the information given by the responsible entities to determine whether a director was independent; we did not test the appropriateness of the responsible entity's classification.

We found that the boards consisted of a mixture of executive directors and non-executive directors, with one board consisting of all non-executive directors and three boards consisting of all executive directors: see Figure 3.

Figure 4 shows the number of executive directors, the number of non-independent non-executive directors and the number of independent non-executive directors that held office for each responsible entity during the relevant period. Across the 10 responsible entities, 47 directors held office during the relevant period: 28 were executive directors and 19 were non-executive directors.

Figure 3: Overview of board composition

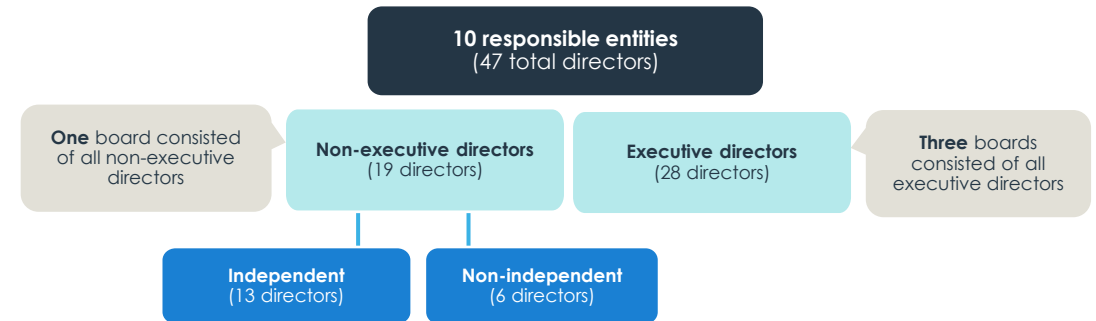
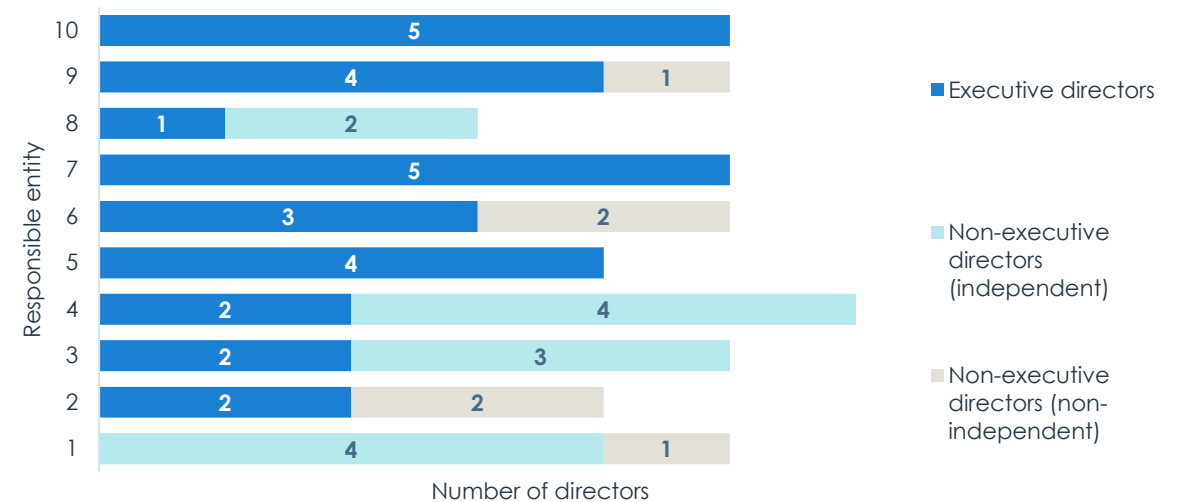


Figure 4: Number of executive and non-executive directors



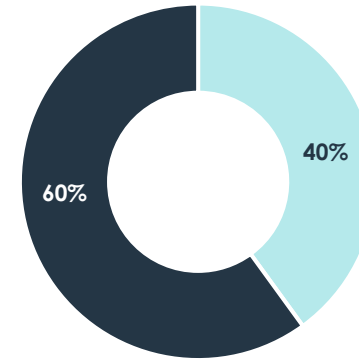
Board composition

Four of the 10 responsible entities we reviewed (40%) had a majority of independent directors: see Figure 5.

In relation to non-executive directors, four of the 10 responsible entities (40%) had a majority of non-executive directors: see Figure 6.

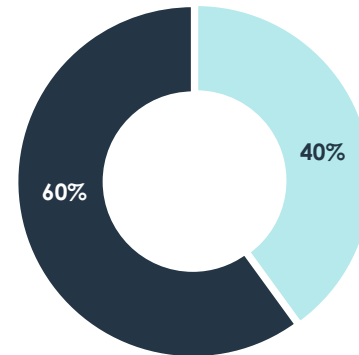
The responsible entities had differing views about the composition of a responsible entity board. Some advocated the presence of executive directors on the board on the basis that executive directors should have a strong understanding of the responsible entity's business and this understanding would optimise the board's decision making.

Figure 5: Board composition in terms of the independence of directors



Four responsible entities (**40%**) had a majority of independent directors. All of the other **six** responsible entities (**60%**) had zero independent directors.

Figure 6: Board composition in terms of whether there was a majority of non-executive directors



Four responsible entities (**40%**) had a majority of non-executive directors. For the other **six** responsible entities (**60%**), five had zero, or a minority of, non-executive directors, and one had equal numbers of non-executive and executive directors.



Board composition

In contrast, other responsible entities supported the selection of non-executive directors due to the objectivity a non-executive director should bring to a board's decision making and the capacity of a non-executive director to avoid potential conflicts between the interests of the responsible entity or other entities in the same corporate group, and the interests of the members of the schemes the responsible entity operates.

Considerations

When considering the composition of its board, does the responsible entity evaluate:

- › executive and non-executive director representation;
- › the number of independent directors and non-independent directors; and
- › how aspects such as information flows and conflict management are undertaken?

Does the responsible entity regularly review board appointment and removal processes to enable the board composition to be optimal for the responsible entity's circumstances?

Board composition – Tenure of directors

The *Corporations Act 2001* (Corporations Act) does not impose a limit on the tenure of a director of a responsible entity. A responsible entity may have tenure limits in force in, for example, its board charter or its policies.

An important aspect of the composition of a responsible entity's board is the tenure profile of the directors. A short average tenure might indicate instability and could bring into question the collective corporate memory and the directors' understanding of the responsible entity's business.

However, an unreasonably long average tenure might suggest a lack of independence and insufficient diversity of perspectives in board decision making.

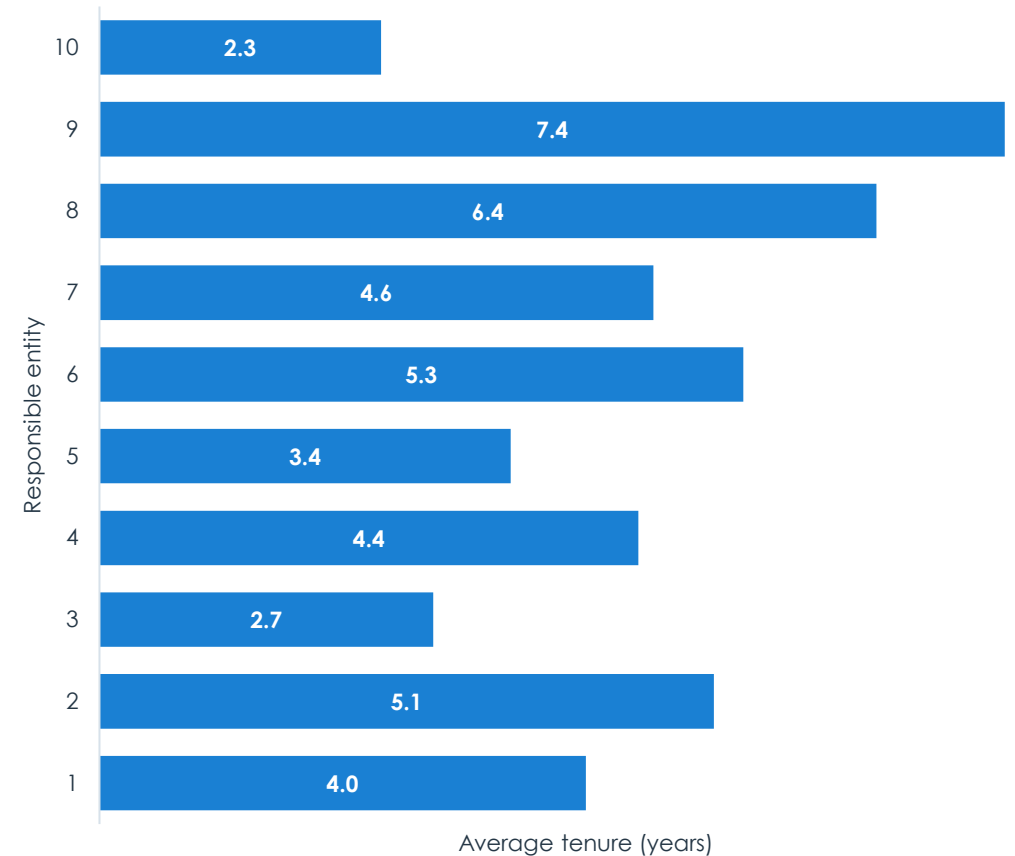
For all directors who were in office during the relevant period, the average tenure was approximately 4.5 years. The shortest average tenure for a director of a responsible entity was 2.3 years and the longest average tenure was 7.4 years. Figure 7 shows the average tenure for each responsible entity.

Considerations

Does the responsible entity review, at least annually, the tenure profile of its directors to achieve a suitable balance between:

- › maintaining stability and knowledge in the board of the responsible entity's business; and
- › refreshing the board's make-up to obtain diverse perspectives and ensure the board's skills and expertise reflect changes in the circumstances of the business?

Figure 7: Average tenure of directors



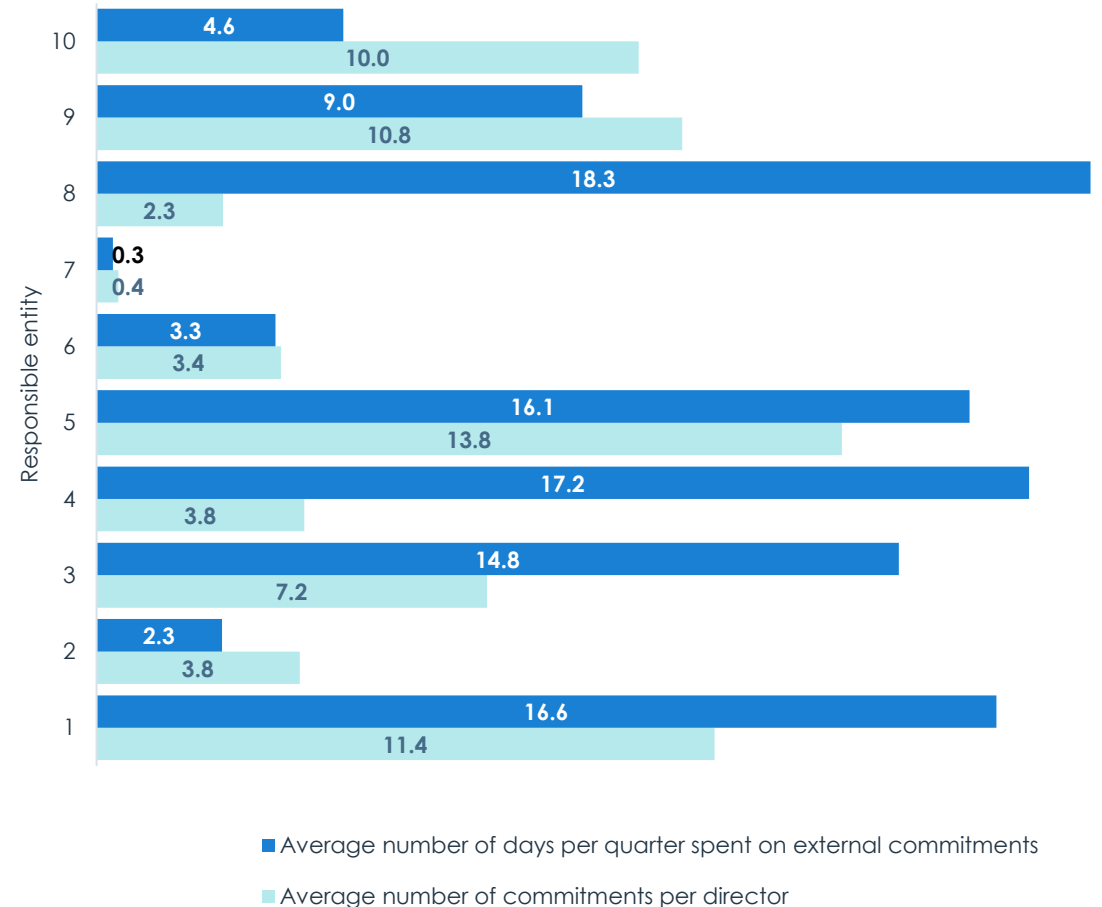
Board composition – External commitments of directors

The Corporations Act does not expressly restrict a responsible entity's director from having other business roles, such as being a director, board chair or committee member at another organisation (including an organisation in the same corporate group as the responsible entity).

A responsible entity should be careful to ensure that its directors are not overly committed with other business roles. If a director is too heavily committed with other business roles, there is a risk they will not have enough time to carry out their duties as a responsible entity director under the Corporations Act to an adequate standard. In turn, this might impact the responsible entity's compliance with its duties under s601FC and 912A.

We relied on the information given by the responsible entities in relation to directors' other business roles. Based on the information provided by the 10 responsible entities, a director during the relevant period had an average of 6.7 external commitments, and the average time spent on external commitments was 10.1 days per quarter. Figure 8 shows the averages for each responsible entity.

Figure 8: External commitments of directors





Board composition – External commitments of directors

We found that, generally, where a director wanted to take on additional roles with other organisations, this would be discussed on a case-by-case basis in light of potential conflicts and the director's overall workload. One responsible entity had a policy about the number of additional roles a director should undertake.

Considerations

Do directors have adequate capacity to carry out their board duties, given the number, types and intensity of all their commitments?

Are there guidelines on external business commitments for directors to ensure that the level of these commitments does not compromise a director's capacity to perform their role?

Do guidelines apply to existing directors and a person that is being considered for appointment as a new director?



Board charters

While the Corporations Act does not require a responsible entity to have a board charter, a well-designed and thorough board charter:

- › is conducive to the effective functioning of the responsible entity; and
- › will assist the responsible entity and its directors and officers to comply with their duties under the Corporations Act.

A board charter must remain suitable to the changing circumstances of a responsible entity's business.

Nine of the responsible entities in our review had board charters. Some board charters were positioned at a high level, and there was variation across the board charters in the depth of coverage of governance areas. One responsible entity had no board charter or terms of reference.

Six responsible entities used a review cycle for the board charter of one to three years. Two responsible entities had an annual review cycle; two responsible entities had a two-year review cycle; and two responsible entities had a three-year review cycle. The remaining three responsible entities that had a board charter did not have a set review period and reviewed the board charter when required.

Considerations

Is the board charter reviewed sufficiently regularly to ensure that it reflects changes in the environment (e.g. regulatory, business) and that the board has clear responsibilities?

Board meetings and committees

For a responsible entity's board to function effectively, it should meet frequently enough to ensure it can perform its role and be adequately supported by board committees.

Figure 9 sets out the number of board meetings that were held for each responsible entity during the relevant period. The average was 13.6 meetings.

The number of board committees ranged from one to 11. The responsible entities had a broad range of board committees, for example audit and risk committees, people and remuneration committees, investment committees, and due diligence committees.

We found that the board committees met regularly and their findings were communicated to the responsible entity's board in a timely manner.

Considerations

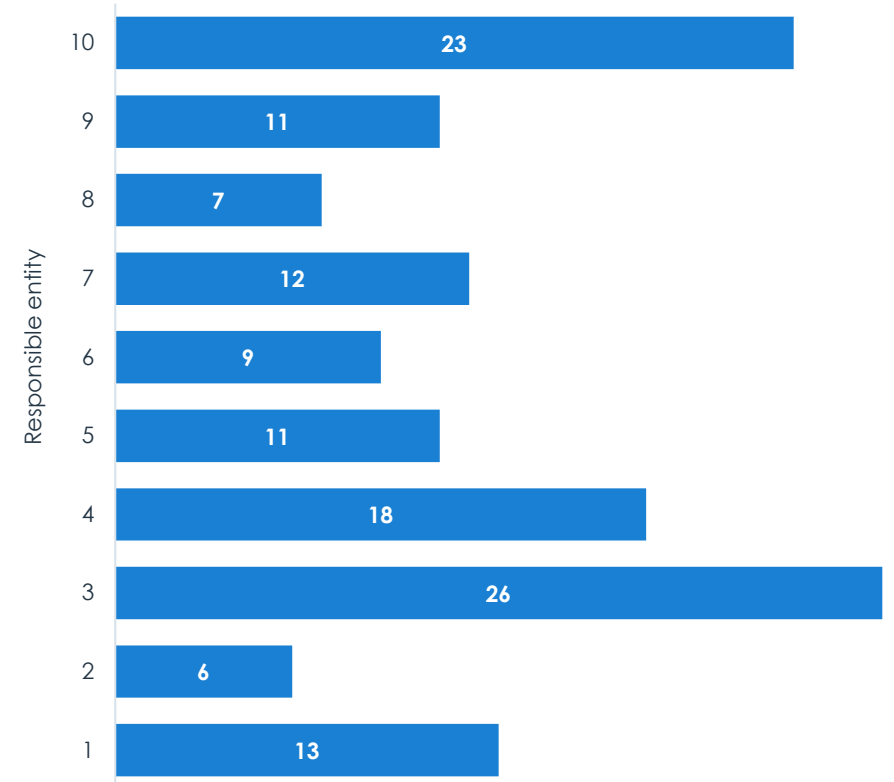
Does the board challenge and question recommendations from the committees to optimise the quality of decision making?

Is the board supported by an appropriate number of committees with members who have the requisite skills and experience?

Are the terms of reference for committees clearly documented, are the delegations clear (including whether the committee may sub-delegate) and are there established governance frameworks (e.g. committee support, reporting)?

Is the framework for reporting by management of material information to the board and committees clear and prominent and is reporting performed in a timely manner?

Figure 9: Number of board meetings



Board performance reviews and skills assessments

Performance reviews

Board performance reviews are generally undertaken annually. However, some are undertaken on an as-needs basis or as an ongoing process and at the board chair's discretion.

Most of the responsible entities in our review had board performance reviews carried out by parties that were not independent of the board. Figure 10 gives a breakdown of the responsible entities in terms of whether the parties that carried out the performance reviews were independent of the board.

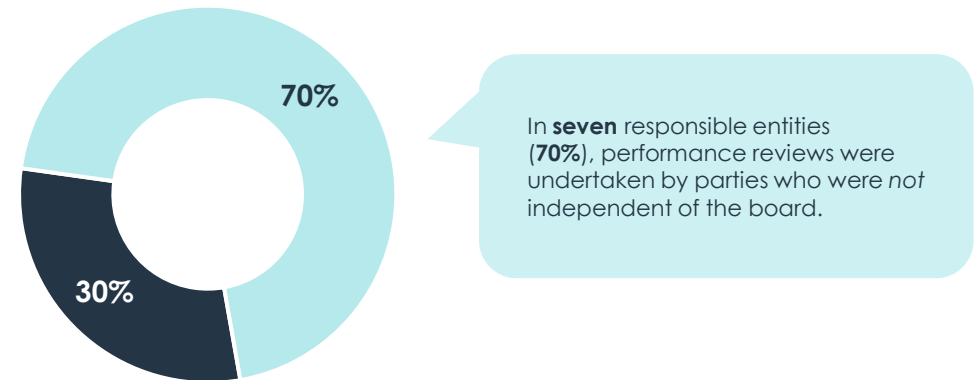
For the responsible entities where board performance reviews were carried out by parties that were not independent of the board:

- › five responsible entities had the reviews based on director feedback of the performance of the board as a whole. The director feedback tended to use questionnaires that covered a range of criteria, such as the board's performance relative to its objectives and the board's interaction with management. Two of these responsible entities had the board performance reviews facilitated by the responsible entity's company secretary and/or legal team; and
- › two responsible entities had the review carried out by the chair.

Board reviews

The utility of board performance reviews and skills assessments depends on the reviews being evidence-based and carried out with objectivity. The objectivity of a review is open to question where the reviewer is not independent of the board.

Figure 10: Independence of the parties reviewing board performance



Board performance reviews and skills assessments

Skills assessments

Six responsible entities carried out the skills assessments at least annually. Three responsible entities had an established process for assessing the skills of the board, but without a stipulated frequency. For these responsible entities:

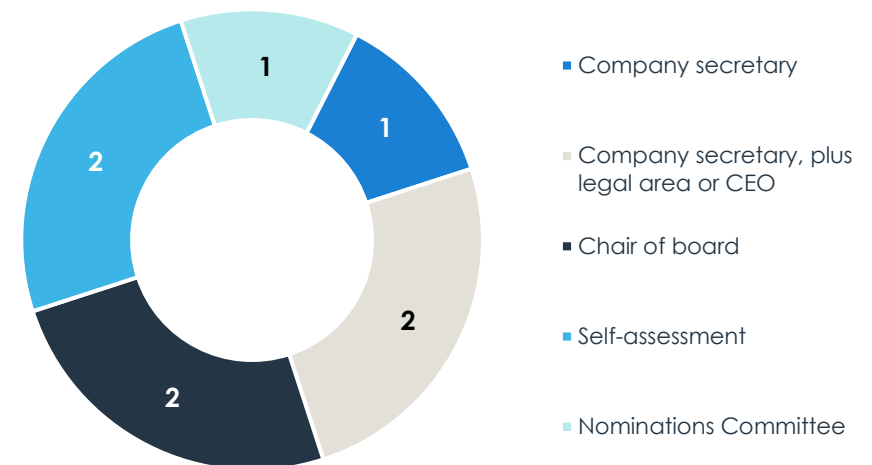
- › one carried out a skills assessment for the board as a whole when a new appointment, or the extension of a director's term, was under consideration;
- › one performed a board skills assessment at the discretion of the chair; and
- › one carried out a skills assessment upon the appointment or cessation of a director, or when there was a material change to the responsible entity's business.

The remaining responsible entity did not appear to have an established process for assessing the skills of the board as a whole.

For the nine responsible entities that had an established process of conducting skills assessments for the board, only one responsible entity had the review carried out by a party that could be regarded as independent of the board.

Figure 11 sets out the categories of parties that carried out skills assessments for the eight boards where the party could be regarded as not independent of the board.

Figure 11: Non-independent parties who undertook board skills assessments





Board performance reviews and skills assessments

Considerations

Does the board undertake periodic board performance reviews and skills assessments to ensure that the board has the requisite skills, experience and level of performance to carry out its duties?

Do board performance reviews include performance evaluations of individual directors as part of the overall assessment of the board's performance?

Are review processes documented, including the frequency of the reviews and the functions of any external parties (e.g. consultants) in the review processes?

Does the board consider the benefits an external firm may be able to bring to these review processes (e.g. mitigation of the risk of 'group think' or subconscious biases and bringing different perspectives)?

When appointing a new director, does the board conduct a skills and experience assessment of the whole board and the individual directors, for both executive and non-executive directors?



Business models and reporting arrangements

What we found

There was a significant degree of variation in the extent to which the responsible entities delegated material functions.

Among the 10 responsible entities:

- › two responsible entities operated a fully outsourced business model under which other entities, including some related entities, provide operational services (e.g. investment management, custody and fund administration);
- › two responsible entities delegated the operation of their registered schemes to a different entity in the corporate group;
- › one responsible entity outsourced the investment management function to another entity in the corporate group;
- › one responsible entity outsourced the risk and compliance functions to another entity in the corporate group; and
- › one responsible entity used a group-based risk management function.

Some responsible entities had more than one of these features.

The responsible entities had documented the delegated authorities and reporting arrangements.

Considerations

Are delegations of authority documented clearly and monitored?

Do delegates understand the capacity in which they can act, and any associated limitations?

For responsible entities that engage other entities within a group structure:

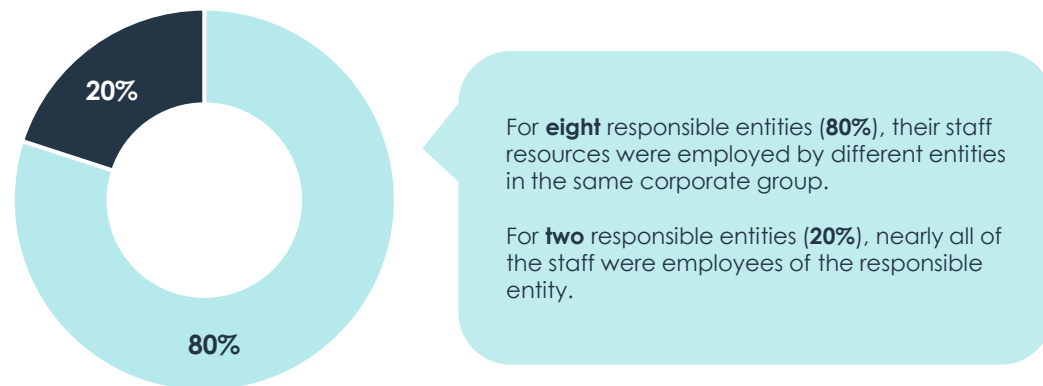
- › Are the arrangements documented and executed appropriately to ensure the directors and officers can meet their responsibilities?
- › Are these arrangements reviewed on a regular basis?
- › In light of the inherent conflicts of interest that may arise when powers or functions are allocated within the same corporate group, does the responsible entity have adequate quality arrangements to monitor a delegate that is a related party?
- › Are adequate arrangements in place to deal with conflicts of interest?

Staffing arrangements

If a responsible entity relies on staff resources from group entities, there is the potential for conflicts of interest. Where a responsible entity uses the services of a person who is employed by a different entity in the same corporate group, there is a risk that the interests of the person's employer will not align with the interests of the responsible entity.

For eight responsible entities, all of the staff resources were employed by different entities in the same corporate group. For the other two responsible entities, staff resources were almost all employed by the responsible entity itself: see Figure 12. One of these two responsible entities also hired contractors from recruitment firms, and the other hired contractors from group affiliate companies, including companies based overseas.

Figure 12: Responsible entity staffing arrangements



Considerations

How and on what basis does the board satisfy itself that, at all times, the responsible entity has adequate staffing resources to perform its duties to an acceptable standard? Are the responsible entity's assessments of the adequacy of staffing resources (including the basis for each assessment) documented?

For responsible entities that use staff who are employed by other entities in the same corporate group:

- › Are staffing arrangements clearly set out (e.g. in a formal shared services agreement) to ensure adequate and qualified staff are available at all times so that the responsible entity can meet its duties under the Corporations Act?
- › What reasonable steps have been taken to identify and manage the conflicts of interest? (Reasonable steps might include staff being required to declare and manage any conflicts between the interests of their employer and the interests of the responsible entity.)
- › Does the responsible entity's risk and compliance function review the conflict declarations on a regular basis and ensure that an employee of a group entity is not deployed to work on a matter where a conflict of interest is reasonably apparent?



Outsourced service providers

What we found

We sought information from the 10 responsible entities about seven categories of outsourced service providers: investment management, custody, fund administration services (including unit pricing, performance measurement and registry, if applicable), information technology services, legal services, proxy voting, and sales and marketing.

In total, the number of outsourced service providers engaged for the relevant period ranged from five to over 150.

The number of outsourced service providers that were related parties of the responsible entity ranged from 0 to 20. For the purposes of this presentation, we relied on the responsible entities' own assessments of whether outsourced service providers were related parties.

The most prevalent category of outsourced service providers was investment managers. Three responsible entities had over 70 investment manager engagements.

Seven of the 10 responsible entities had processes for the appointment and monitoring of outsourced service providers that did not differentiate between related parties and non-related parties. Two responsible entities had specialised processes for both the appointment and monitoring of service providers, whereas one responsible entity had a specialised process for appointments only.

As a category of AFS licensees, responsible entities should bear in mind ASIC's guidance in relation to outsourcing as outlined in [Regulatory Guide 104](#) *AFS licensing: Meeting the general obligations* (RG 104) at RG 104.36.

Considerations

Are contract terms with outsourced service providers reviewed to ensure that these terms are in the best interests of members (e.g. are the agreements of a suitable duration and do they include appropriate termination clauses)?

Does the responsible entity consider the frequency of contract reviews with service providers to ensure that these contracts reflect current servicing requirements?

Does the responsible entity ensure that any applicable policies or procedures clearly articulate that the responsible entity remains responsible for the actions of the outsourced service providers, irrespective of whether the service is provided by a related party or the oversight is delegated to another party?

How does the responsible entity evaluate the performance of outsourced service providers? For example:

- › Is self-assessment by service providers limited to objective measures (e.g. timeframes for taking specific action) as much as practicable?
- › Do parties that are independent of the service provider assess its performance?
- › Is the assessment carried out with reasonable frequency?
- › Is the assessment of material service providers brought to the board's attention in a timely manner?



Related party transactions

Under Pt 5C.7 of the Corporations Act, the responsible entity of a registered scheme must obtain member approval to provide a financial benefit to itself or to a related party of the responsible entity unless that benefit is given on arm's length terms, or on terms less favourable to the related party: s210 and 601LA.

Responsible entities should bear in mind ASIC's guidance in [Regulatory Guide 76 Related party transactions \(RG 76\)](#), Section C of which includes an analysis of the arm's length exception.

A related party transaction inherently raises the question of whether the transaction is in the best interests of the scheme's members and whether the responsible entity has adequately dealt with conflicts of interest. The quality of a responsible entity's engagement with related party transactions is relevant to:

- › whether the responsible entity has complied with the member approval requirements;
- › whether the responsible entity and its directors and officers have complied with their duties, including the duties under the Corporations Act to act in the best interests of members and to prefer those interests, in a decision to enter into a related party transaction and the subsequent monitoring of the transaction; and
- › whether the responsible entity has put in place adequate arrangements for the management of conflicts of interest in the provision of financial services, as required under s912A(1)(aa).

Considerations

Does the board have oversight of material related-party transactions?

When the responsible entity considers entering into a transaction with a related party, are the merits of the transaction carefully reviewed and are there processes and policies in place to ensure that, to the extent possible, the transaction is on arm's length terms?

Are the responsible entity's conflicts management frameworks and processes for appointing, monitoring and terminating outsourced service providers designed to adequately deal with related party transactions?



Use of independent experts

For six responsible entities, the prevailing practice during the relevant period was that the decision about whether to engage experts or consultants was generally made by the responsible entity's management, rather than the board. Another responsible entity had a related entity decide on whether to engage experts or consultants. For one responsible entity, the general approach was for the board, rather than management, to engage experts or consultants. For another responsible entity, the board only occasionally engaged experts or consultants. The remaining responsible entity did not engage experts or consultants at all during the relevant period.

We found that, from the categories of independent experts identified in response to our review, the use of external experts or consultants by responsible entities was most prevalent in the areas of compliance and/or risk management and legal services.

Considerations

Does the use of independent experts signal a potential skills deficiency at the board level, at the board committee level, or at the management level of the responsible entity?

Does the board or board committee have the skills and ability to challenge and critically assess the information provided by independent experts?



Conflicts management

Under the Corporations Act, where the director of a responsible entity has a conflict of interest in relation to a matter under consideration at a board meeting, the director may be unable to lawfully vote on the matter or remain present at the meeting while the matter is under consideration. See section 195 of the Corporations Act and our guidance on the concept of a 'material personal interest' in [RG 76](#) at RG 76.31–RG 76.38.

We sought explanations from the responsible entities about how they approached situations during the relevant period where a director had an actual or potential conflict of interest in relation to a matter before the board. An assessment of whether each actual or potential conflict identified was caught by s195(1) was outside the scope of this preliminary review.

The responsible entities dealt with the extent to which a conflicted director should remove themselves from the consideration of the matter on a case-by-case basis. In some cases, the director participated in the discussion about the substantive matter and did not vote on it. In other cases, the director remained in the room without participating in the discussion and did not vote on the substantive matter.

There were significant differences among the responsible entities about which parties determine whether (and, if so, to what extent) a director should be involved in considering a matter at a board meeting where the director has a conflict of interest.

For three responsible entities, the prevailing approach was that the director would make the decision. The main approach for two responsible entities was that the non-conflicted directors would determine the matter.

The remaining five responsible entities appeared to take a case-by-case approach to determine the extent of a conflicted director's involvement in a matter before the board.

Where s195(1) applies to a director, the director will not be allowed to stay in the room, even if they do not participate in the discussion. The director remaining in the room, albeit in a passive capacity, can stifle the discussion of the matter and may impact how other directors vote.

Considerations

Does the responsible entity:

- › focus on the management of conflicts when acting in the best interests of members; and
- › emphasise the proactive measures that can be adopted, for example, around culture and having an 'investor first' mindset?

For responsible entities that rely on staff from within a corporate group, does the responsible entity consider how it may best manage any potential conflicts and ensure those staff understand the capacity in which they are acting where they support wider group functions?



Compliance management

Compliance committees

A responsible entity of a registered scheme must establish a compliance committee if less than half of its directors are external directors: s601JA(1). An 'external director' is a director who satisfies the requirements under s601JA(2). The compliance committee of a registered scheme must have at least three members, with a majority of those being external members (as defined in s601JB(2)): s601JB(1).

Six of the 10 responsible entities had a compliance committee, as required by the Corporations Act due to the responsible entity not having a majority of external directors. The remaining four responsible entities were not required to have, and did not have, a compliance committee because they had a majority of independent directors.

Compliance plans

Under s601HA, the compliance plan of a registered scheme must set out adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with the Corporations Act and the scheme's constitution. A scheme's compliance plan may incorporate, by reference, provisions from the compliance plan of another registered scheme: s601HB.

For most of the responsible entities in our review, scheme compliance plans extensively incorporated by reference, in full or to a substantial extent, the provisions of master compliance plans of other schemes the responsible entity operated.

Policies

All 10 responsible entities used or adapted corporate group policies across a broad range of areas, including remuneration policies, conflict of interest policies and risk management frameworks.



Compliance management

Considerations

Compliance committees

Are information flows to the compliance committee managed and communicated appropriately and in a timely manner, particularly when they occur through informal or indirect interactions?

Where a responsible entity is part of a corporate group, does the compliance committee communicate directly to the board (i.e. communicating to a group entity is not used as a substitute communication avenue)?

Is the number of compliance committee members appropriate taking into account the volume and complexity of scheme types and associated compliance plans?

Compliance plans

Are compliance plans fit-for-purpose for each scheme? Are they suitable for the types of underlying assets that a scheme invests in and the risks that relate to the scheme's investments and operations?

Policies

For a responsible entity that uses, or adapts, a group-level policy, is the suitability of this approach regularly reviewed, especially when the group-level policy changes?



Appendix 1: List of responsible entities reviewed

- › AMP Capital Funds Management Limited
- › BlackRock Investment Management (Australia) Limited
- › BT Funds Management Limited
- › Colonial First State Investments Limited
- › Equity Trustees Limited
- › Macquarie Investment Management Australia Limited
- › Mercer Investments (Australia) Limited
- › Perpetual Trust Services Limited
- › Russell Investment Management Limited
- › Vanguard Investments Australia Limited