TRUSTS, FOUNDATIONS AND COMMUNITY GOVERNANCE: INSIGHTS FROM NEW ZEALAND AND AUSTRALIAN EXPERIENCE

A note prepared as part of a discussion with the European Centre for Foundations on the evolving role of trusts and foundations

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Introduction

This note explores emerging thinking on the potential of trusts and foundations to play a potentially pivotal role in community governance. It draws primarily on New Zealand and Australian experience, but benefits also from discussions with colleagues in the *Philanthropication Through Privatisation* project (The PtP website URL is p-t-p.org).

A working definition of community governance is taken from a research report prepared by McKinlay Douglas Ltd[1] in partnership with the Australian Centre of Excellence for Local Government, the Municipal Association of Victoria, Local Government Managers Australia and the Bendigo & Adelaide Bank Limited[2] which elected to define 'community governance' as a "collaborative approach to determining a community's preferred futures and developing and implementing the means of realising them. In practice it may or may not involve one or more of the different tiers of government, institutions of civil society, and private sector interests. We have taken the view that the critical issue in defining 'community governance' is not whether clear and specific boundaries can be set around it, but whether it has utility in the sense of improving understanding of how decisions which affect a community's future are best taken and implemented."

This definition recognises that community governance is no longer the sole or principal prerogative of local government – rather, that a number of different institutions, both formal and informal, are becoming important participants in shaping the future of communities. In turn, this raises new and important questions regarding mandate and accountability, as well as providing new opportunities for considering the strengths and weaknesses of different institutional arrangements for different aspects of community-based, or community-reflective, decision-making.

These questions were highlighted by involvement in the *Philanthropication Through Privatisation* project, and consideration of case studies from a number of different jurisdictions involving foundations which had resulted from some form of privatisation of previously public, and often 'ownerless', assets (with the term privatisation understood as extending to the restructuring of assets to create a more formal, typically commercial, ownership structure and associated with that the creation of foundations to play the role of owner). One theme which could be seen as coming through at least some of these case studies was the emergence of a new category of trusts or foundations: entities which had legal powers to

[1] www.mdl.co.nz
[2] See *Evolution in Community Governance: Building on What Works* http://www.acelg.org.au/system/files/publication-documents/1335499377_Vol1_Community_Governance_20_April_2012.pdf.

deal with their income and capital but no mandate in the sense of a mission established by a founder or developed through some form of engagement with the community or communities being served by the foundation.

This was in marked contrast with major private foundations where typically the mission is either embedded in the instrument establishing the foundation, or through the way in which the trustees for the time being are selected, or a combination.

New Zealand's community trusts which were considered within the PTP project, and energy trusts which were not, are both examples where the trusts have broad legal powers to apply income and capital for the benefit of the communities they serve, but no formal legally required means of determining how priorities should be established, and what mix of outcomes their activities should promote (although in the case of the energy trusts because of the variety there are some exceptions and also often a sense that their activities should support the interests of energy consumers because the assets they hold originated from investments built up by consumers through the previous entities).

A brief overview of the origins and practice of New Zealand's community and energy trusts, and of community banking in Australia which is in many respects broadly equivalent in terms of the need to develop a mandate for distribution, will help set the context before turning to discuss specifically the role of trusts and in community governance and the potential this opens up for trusts and foundations generally.

New Zealand

New Zealand's 1984 general election resulted in a government committed to broad-based economic reform which was seen as essential to address deep-seated imbalances in the New Zealand economy, and persistent under-performance which was threatening the ability of the government to support many of the social programs which were seen as an inherent part of the New Zealand 'social contract'. This included a comprehensive reform of the financial sector in which the government was deeply involved as owner and or guarantor, and a restructuring of all aspects of the electricity industry again to replace government dominated entities with entities structured on more commercial lines. In both instances the prevailing viewpoint was that commercial structures, commercial skills and commercial accountability were essential prerequisites for improving performance in industries which were significantly underperforming at what was believed to be very considerable cost both to taxpayers and the economy at large.

Community trusts

New Zealand had a network of regional savings banks which were 'ownerless' and governed by trustees who were appointed in terms of the controlling legislation. Their deposits were government guaranteed. From time to time individual savings banks distributed part of their surplus for 'community purposes' within the region they served. However these distributions were never significant and, unlike (say) Italy's regional savings banks they were not an integral part of funding significant local infrastructure or activity.

In the late 1980s the government decided they should be restructured as companies, and the government guarantee withdrawn over a period of time. This raised the question of who should own the resultant companies. At the time most of the regional savings banks were seen as having relatively little value[3] and in any event the government's focus was not so much on capturing the value as on creating more efficient structures and terminating the exposure it had through the guarantee.

The savings banks themselves argued that the ownership of the new companies should be vested in trusts created to hold the income and capital for the benefit of the communities they served. This argument was accepted and the share capital of the new companies vested in a series of community trusts.

The newly corporatised trustee savings banks proved to be much more successful than anticipated, partly because government policy brought inflation under control thus reversing the loss on government stock holdings, and partly because the local franchises these banks had built up proved attractive to major commercial banks with the ownership of all but one of the new companies eventually passing into overseas ownership at a significant premium.

The legislation governing the trusts provides:

"Property vested in, or belonging to, a community trust must be—

- (a) held on trust to be applied for charitable, cultural, philanthropic, recreational, and other purposes; and

- (b) applied for purposes that are beneficial to the community principally in the area or region of the trust.

(2) The purposes of a community trust are deemed to be charitable for the purposes of the application to a community trust of any enactment or rule of law."

The practical effect is that trusts have very wide discretion in terms of how they apply income and capital. There is no provision requiring them to gain any kind of specific mandate from their communities about how they should establish priorities although the better trusts have gone to very considerable lengths to develop priority areas of activity in consultation with their communities.

Their success in building up the value of their investments over time now means that, in a number of New Zealand's communities, the local community trust is the most significant discretionary funder. Inevitably as a consequence, funding decisions by community trusts have an important impact on the governance of communities. Like it or not, they have become a significant element of community governance but without any of the formal checks and balances, or processes desirable to properly reflect community priorities.

In the case of community trusts this is compounded by a now out-dated practice for the appointment of trustees. They are appointed by the Minister of Finance, a practice which goes back to the fact that, when the trusts were first established, they controlled a small but important part of New Zealand's banking sector. Providing for appointment by the Minister of Finance was seen as a means of ensuring that trustees were likely to have the governance skills required of a body which owned a registered bank.

[3] This was partly a result of a government requirement that a significant proportion of total deposits be invested in government stock. Rampant inflation in the mid-1980s had seen interest rates rise to 18% in contrast to coupon rates on the government stock in single figures so that on a 'marked to market' basis banks were showing significant losses.

With one exception, community trusts no longer have any involvement in bank ownership but the practice of appointment by the Minister of Finance continues in large part because it provides a convenient means for governing parties to reward party loyalists as appointment as trustees of community trusts is highly prized.

Energy trusts

The restructuring of New Zealand's electricity sector included abolishing a number of special-purpose local authorities known as electric power boards, and replacing them with companies to own the local distribution activity. As with the companies formed to replace regional trustee savings banks, this also raised the question of who should own the new companies. The government of the day adopted a somewhat unusual process under which:

- The elected members of former electric power boards were replaced by directors designate for the new companies.
- The legislation providing for the restructuring of power boards included provision to the effect that the directors designate were to develop an ownership proposal (a) in consultation with the local community through a statutorily determined consultation process and (b) which required the approval of the former elected members and the consent of the Minister of Energy.

The legislation did not favour any particular form of on-going ownership. Again, as with the regional savings banks, the main interest of the government was in putting in place what it saw as an essential organisational change. There was never any suggestion that government might be able to claim ownership, in part because it was widely recognised that the value in the local retail distribution businesses had been built up out of retentions from charges to consumers.

The result was a number of different forms of ownership. These included:

- Full share giveaways to consumers.
- Partial share giveaways with the remaining shares being vested in a trust for the benefit of the local community and/or local consumers.
- One charitable trust.
- One trust for local economic development.
- In the majority of cases 100% trust ownership of the resultant company with income and assets to be held for the benefit of the community and/or local consumers (this was predominantly in rural and provincial areas with the motivation of trying to replicate, as closely as possible, the type of public ownership which had existed under the previous electric power boards).

One consequence of the restructuring has been that the resultant local power companies all typically earn 'normal' profits. That they should do so was part of the government's objective of ensuring that investment decisions in the electricity sector followed normal commercial principles including the proper pricing of capital. This means that the energy trusts themselves hold substantial assets on which they earn a normal rate of return. The trust deeds for most of the trusts give trustees discretion to choose between distributions to consumers and distributions for community purposes often linked to the use of energy.

Again, energy trusts are in broadly the same situation as community trusts. They have legal powers regarding the use of their income and capital, but typically lack a mandate. Interestingly this applies even although in most cases trustees are actually elected by consumers triennially. The reason is that consumers lack any significant information about the range of possibilities, and election campaigns are normally operated on a combination of continuing to retain ownership locally, and maintain consumer distributions. It is also typical that elections for special purpose entities tend to attract very low turnout because they are often seen as peripheral to the interests of electors.

Australia

Although Australia has no equivalent of New Zealand's community and energy trusts, it does have its own unique and very effective network of institutions which are increasingly an important part of community governance. These are the locally owned bank branches within the Bendigo & Adelaide Bank Ltd's community banking network.

Some 15 years ago the then Bendigo bank was a small regionally-based bank operating mainly in the Australian state of Victoria. It had originally been established in the goldmining centre of Bendigo as a building society with the purpose of assisting miners acquire their own homes. After more than a century of operating as a locally focused building society, it was restructured as a limited liability company and listed on the Australian Stock Exchange, largely because of a recognition that as a building society it would become increasingly uncompetitive and less able to serve its depositors and communities.

Banking in the early 1990s in Australia was marked by very widespread closure of branches by Australia's main banks, especially branches in rural and provincial Australia. The result was a number of communities lobbying every bank in Australia to come and establish a branch in order to ensure that banking services would remain.

The main driver for bank closures was profitability. Increasingly banks were treating individual branches as profit centres. If they did not meet performance criteria, they were closed.

Bendigo saw this as an opportunity. It recognised the potential to risk share with local communities in a way which could both grow Bendigo's business, and provide a genuinely valuable service to under banked communities. To do this it developed a community bank franchise. Local branches would be owned by separately incorporated companies with a constitution designed to preserve local ownership and control. An important feature was one shareholder one vote rather than one share one vote. Directors are appointed by shareholders but from the local community and typically serve without remuneration - being a community bank director is seen as a relatively high status way of enabling successful citizens especially business people to put something back into the community.

Before Bendigo will grant a franchise, it requires the community to go through a carefully designed feasibility study to determine the prospects of a branch being viable. If the result is favourable, the community is then required to raise the capital to establish the branch and provide it with an adequate working capital cushion (under the franchise agreement, the company owning the local branch is responsible for set up costs and all operating expenses). Bendigo requires widespread local ownership among other things as a means of ensuring broad-based community support.

Once established and earning profits, the surplus is to be distributed partly to shareholders (with an informal cap related to a five-year bank deposit rate), partly to reserves and partly for distributions to the community.

In the early years, bank branches would typically operate what could be described as a 'post office' distribution policy - responding to whatever requests came through the mail. Most expenditure would go on things such as repairing local sports facilities, grants to local clubs etc.

More recently there has been an increasing focus on seeing the money available for distribution as a community asset, with an obligation on directors to ensure that as far as possible they apply distributions to promote outcomes which are high priority for the community. This puts a strong focus on getting to understand the community and its issues.

In doing this the community banking network is supported by a strong team within the bank itself who provide significant ongoing professional development and other support for individual banks. Branches also combine together through their own association which is increasingly committed to the practice of community governance.

The interest from this example is its illustration that community governance is not the sole prerogative of public bodies or NGOs but is equally something which can be part of the core business strategy of private sector entities. In this case the Bendigo & Adelaide Bank is very much an example of doing well through doing good. The commitment to community is genuine (a judgement based on extensive interviews with Bendigo bank personnel and other stakeholders) but it is also a strategy which has underpinned significant growth of the bank as a whole.

The bank is also providing an exemplar for other institutional networks (local government; government agencies) who themselves have an interest in working more effectively with their communities.

Foundations as mandated participants in community governance: the Gisborne example

The energy trusts' establishment process, as noted, threw up a number of different options. One, quite unintentionally, contains within it the potential for establishing a genuine mandate free from short-term political influence. This is the Eastland Community Trust (ECT), the energy trust established to own the company formed from the Poverty Bay Electric Power Board, the retail distribution entity which served the Gisborne region on the east coast of New Zealand's North Island. This is one of the more remote parts of New Zealand and in relative terms one of the most deprived.

The trust's primary objective is to promote local economic development. The trust deed contains no definition of local economic development and trustees have traditionally taken a broad view of what it could encompass. However they do this within a set of governance arrangements which provide significant elements of a mandate.

The trust deed for the trust provides that trustees should be appointed by the Gisborne district Council but on the basis that they are 'fit for purpose'. The deed prevents the Council from simply 'stacking' the board with its own representatives.

The deed also requires the trustees to prepare, each year, what is known as a statement of intent. This is a process which was developed initially in New Zealand for government owned companies. The purpose was to strike a balance between ensuring that boards of directors could exercise their commercial skill and discretion in running the business of the company with the interest Ministers had in being satisfied in advance about the nature of the business or businesses which would be undertaken, the likely risks, the procedures which would be gone through in acquiring or disposing of any major assets, key financial and non-financial performance indicators and other matters of interest to ministers as representatives of the government as owner.

The trust's statement of intent is discussed with the Gisborne District Council which, in its role as the elected representatives of the community, is able to present what is seen as a community perspective on the priorities which the trust is setting for its distribution activity and the on-going management of the businesses it owns. The trust however is the sole decision maker on the final content of the statement of intent.

The process is a useful tool for ensuring that trustees' priorities are set with an understanding of what matters for the community itself. It is not yet perfect, and along with the process for appointing trustees is likely to undergo further review and refinement. Possibilities include:

- Amending the trust deed so that instead of trustees being appointed by the Gisborne District Council itself, they are appointed by an electoral College whose members are selected by the Council and perhaps other stakeholders. This would serve the twofold purpose of further distancing the trust from any possibility of political influence, and providing a broader base of community leadership as the tool for selecting trustees.
- Adopting a partnership approach with its communities in setting priorities for dealing with trust income. One possible example is the type of community engagement followed by cities such as Portland and Seattle with their comprehensive networks of neighbourhood associations.

The ECT structure and accountabilities have been an important factor in its effectiveness as the owner of major local infrastructure including the electricity distribution network and the Gisborne Port. The way the trust deed insulates trustees from short-term political influence means that they are better able to take long-term strategic decisions rather than concentrate on satisfying immediate demands. The benefits from this appear from its relative performance as against other energy trusts which began in similar circumstances but operate with elected trustees who are far more responsive to short-term consumer interests.

A further factor which should not be underestimated is the different understandings which people bring to the role of trustee as compared to those which they bring to the role of elected member. There is a culture and tradition about the role of trustees, including an understanding of the nature of service which is quite different from the motivation which appears to drive most politicians. It has certainly been a significant factor in the success of the Eastland community trust and arguably would be equally important in the new role for foundations discussed below.

Assessment: a new role for foundations?

This note has argued that the emergence of foundations as one of the outcomes from significant public sector restructuring or privatisation raises important questions about mandate and accountability. Typically these foundations have legal powers but lack a mandate to specify how those powers should be applied, and what priorities the foundations themselves should serve.

The Gisborne example, ECT, provides a good and evolving example of how such a foundation or trust can actually obtain a mandate by the adoption of a deliberative process for setting out its priorities both for distribution and for investment and doing so in consultation with the community's democratic representatives. The potential involvement of the community itself in partnership through (say) a network of neighbourhood associations provides an example of how existing good practice can be drawn on to further enhance the trust's mandate.

Further support for the importance of developing partnership/consultative arrangements with communities comes from the experience of the Bendigo & Adelaide Bank which, although not a trust or foundation, has through its community bank branches an equivalent function.

There is a further and in some respects potentially even more significant potential for this new approach to the use of foundations; the ownership of major local infrastructure and assets and/or services in the sense of responsibility for delivery.

A major concern at the moment in a number of developed countries is the way in which the democratic process has been evolving towards much more of a short-term highly politicised approach to policy development, and to campaigning for office. The ECT example illustrates how the governance and management of local public assets could be to a significant degree divorced from short-term political influences. Taken to a possibly desirable extreme, it raises the question of whether elected local authorities, rather than being service deliverers themselves, should be more in the nature of elected electoral colleges whose principal role is to select fit for purpose governing bodies for the entities which actually manage and deliver local government services.