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Australian Prudential Regulation Authority (APRA)
1 Martin Place
Sydney NSW 2001

Via email to:

16 February 2022

Subject: **Superannuation Prudential Standard 530 Investment Governance (SPS 530) – Proposed Revisions**

Dear Sir/Madam

Thank you for the opportunity to respond to APRA's proposed revisions to SPS 530 as published on 29 September 2021.

Support for the intent of the revisions

Mercer believes that a robust investment governance framework helps to build resilience by mitigating risks that can adversely impact investment outcomes. The changes proposed by APRA to SPS 530 are a positive development and we support the enhancements these changes will have on Trustees' investment governance frameworks.

Further Guidance

We note, however, that in practice the application of the proposed changes will depend to a great extent on the guidance APRA provides in Prudential Practice Guide 530 (**SPG 530**), which the industry relies on heavily in developing and updating relevant policies and processes.

We understand it is APRA's intention to consult on updates to SPG 530 at the conclusion of the SPS 530 consultation period. We have therefore provided comments below that APRA may wish to consider addressing in its guidance so as to clearly set an appropriate level of expectation for superannuation funds.

Stress Testing Methodology

In the existing SPG 530 at paragraph 151, in relation to stress testing methodology, the guide suggests that "*hypothetical events are typically tailored constructions of low probability plausible future events*". However, the proposed changes to SPS 530 appears to lift this requirement in paragraph 30 to "*These adverse stress scenarios must…..make the control of risk within an accepted tolerance level in the investment strategy difficult*". It is quite possible that the control of risk will only become difficult in an implausible event.

We therefore suggest that *SPG 530 provide guidance that Trustees construct plausible adverse stress scenarios that…create extraordinary losses or make the control of risk…difficult.*

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Board oversight

We strongly support the proposed enhancements to board oversight of investment governance arrangements. We note the proposed changes do not prescribe the form or content of reporting for boards (or their committees) but rather apply a principles-based approach. We agree with this approach given the variety of governance structures and investment strategies used in the industry. However, whilst we agree that boards should not be forced into one particular reporting structure, we believe there is value in providing more guidance to boards on how to build effective reporting frameworks. In this context, we make the following observations:

Clarifying the difference between board and management reporting

The proposed amendment to para 26 applies the same requirement for board and management reporting:

> 26. An RSE licensee must ensure that the performance of each investment and investment option is regularly reported to the Board and senior management. This reporting must include an assessment of the sources of out-performance and under-performance relative to appropriate performance benchmarks as determined by the RSE licensee under paragraph 24.

Whilst we agree that providing attribution analysis is important, the level of detail should differ between what is provided to the Board for oversight purposes and what is provided to management for the purposes of detailed analysis and review. As noted below, we generally do not consider it valuable for boards to be provided with detailed technical raw data and analysis (which is typically provided to management) – refer below for our suggestions on improving investment reporting frameworks. We therefore suggest it would be helpful if the updated SPG 530 includes some commentary on APRA's expectations in this regard.

The same comments are also relevant to reporting on the performance of "each investment". Whilst we agree it is important for boards to have access to this information, given the number of investments involved, it would be of little value for boards to be inundated with long spreadsheets of raw data. As noted below, we believe the better approach is to provide useful summaries of the most salient issues and risks.

Effective reporting framework

In our experience, the reporting framework is an essential building block of any effective governance framework (including investment governance framework) and that proper information management is central to a board's ability to provide proper oversight, including in relation to investment arrangements. However in practice getting the right information (right in terms of volume, structure and focus on critical issues) can be challenging for many boards. We suggest there is value in APRA encouraging trustees to place greater focus on their reporting frameworks and to also include in the revised SPG 530 principles-based guidelines on relevant considerations to take into account in building a reporting framework.

Based on our experience, we suggest some key considerations for building an effective reporting framework should include:

- Board expertise – Board reporting needs to match the capabilities and expertise of the Board as a whole (e.g. use of investment jargon or complex analytics)

- Nature of investments – Board reporting should be commensurate with the complexity and risk of existing and any proposed investments (e.g. format and content of information should place the Board in a position to ask questions not only about the appropriateness of such investments but also to enable directors to test and understand the associated risks and the adequacy of management's controls.)

- Scope of Delegations – reporting practices should align with the scope of the delegations. As a general principle, the more responsibilities a board delegates, the greater should be the scope of the Board's monitoring of those delegations.

- Governance Structure –the nature and extent of information provided to the Board will depend on whether the Board has in place an Investment Committee and the role and expertise of that committee. The format and content of reporting from the Investment Committee to the Board will also be an important consideration.

- Streamlined and structured content – investment reports should have appropriate balance between information and raw data and be streamlined to assist the Board in identifying and understanding the key issues and the most salient facts as well as to prepare directors to ask relevant questions and make informed decisions. Information should be structured in such a way that the Board is provided with the highest layer of information, and should directors have specific questions, lower layer information can be readily provided.

- Focus on critical issues – information provided to some boards is heavily (if not predominantly) focused on historical investment performance and in many cases insufficient time is spent by boards on macro-economic issues or discussing emerging financial and non-financial risks that could adversely impact investments and strategy. Investment reports should provide the Board with a deeper understanding of potential risks, opportunities and challenges. Better practice is also for board papers to prioritise investment risks according to their importance.

- Timeliness – historical performance information should be supplemented by any material recent developments.

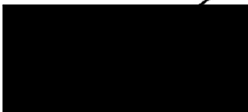
- Objectivity – directors, in consultation with management, should drive the information requirements of the Board. However, we have observed that in some cases investment reporting is determined almost entirely by management. We suggest there is benefit in reinforcing the need for boards to take a leadership role in determining the nature and format of its investment reports.

We also suggest there is value in APRA specifically referencing the need to review the reporting frameworks as part of the tri-ennial review of the investment governance framework.

Finally, for avoidance of doubt we wish to clarify that we are not suggesting the introduction of new reporting requirements. Indeed, in our view the existing principles-based requirements in the proposed SPS 530 are adequate (e.g. para12(b) (to have a methodology for determining investment reporting measures), revised para 12(e) (structures, policies and processes for reporting to the Board), para 26 (requiring reporting on investment performance and attribution analysis), para 32(b) in relation to stress testing; para 35(g) in relation to oversight of liquidity management and para 39(b) relating to valuation). Our suggestions simply recognise that poor information flow to boards is often the root cause of many issues as evidenced in recent times and therefore taking the opportunity to address this topic in more detail when updating APRA's SPG 530 guidelines will, in our view, enhance trustees' focus on board reporting practices and thereby help to improve the quality of oversight and monitoring provided by trustee boards.

As always, Mercer welcomes the opportunity to contribute to improving Australia's superannuation industry for the benefit of fund members. Please do not hesitate to contact me if you would like to arrange a discussion or need further information in respect of the above matters.

Yours sincerely,



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