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16 February 2022

Australian Prudential Regulation Authority
Email: [redacted]

Dear Sir/Madam

PRUDENTIAL STANDARD SPS 530: INVESTMENT GOVERNANCE

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission related to Prudential Standard SPS 530: Investment Governance.

About ACSI

Established in 2001, ACSI exists to provide a strong voice on financially material environmental, social and governance (ESG) issues. Our members include 34 Australian and international asset owners and institutional investors with over $1trillion in funds under management.

Through research, engagement, advocacy and voting advice, ACSI supports members in exercising active ownership to strengthen investment outcomes. Active ownership allows institutional investors to enhance the long-term value of retirement savings entrusted to them to manage. ACSI members can achieve financial outcomes for their beneficiaries through genuine and permanent improvements to the environment, social and governance (ESG) practices of the companies in which they invest.

ACSI's perspective comes from our long-standing practice of engagement with listed companies in relation to their management of financially material ESG risks and opportunities.

Recognising and managing ESG risks

ACSI welcomes APRA's consultation on Prudential Standard SPS 530, which supports RSE licensees to fulfil their fiduciary duties and prudently manage investments in the best financial interests of their beneficiaries. We support SPS 530's guidance that RSE licensees must identify risk factors and sources of return on investments. In addition to this guidance, it would be useful for APRA to provide more specific guidance on types of risk. In particular, APRA could make clear that prudent risk management requires consideration of environmental, social and governance (ESG) factors where they are financially material risks. APRA previously stated that it planned to update guidance and provide further clarity on the obligations of RSE licensees to take into account ESG factors when setting their investment strategies.[1]

In order to act in the best financial interests of their beneficiaries, investors must consider the ESG risks in their investments. Weaknesses in the management of ESG factors have clear financial impacts and present financially material risks. There are many studies demonstrating that organisations with better performance on environmental, social and governance issues also perform better financially.[2] As ASIC has stated, '[b]oards cannot afford to ignore the oversight of non-financial risks. As we have seen, all risk can have financial consequences. If not well managed, non-financial risks carry very real financial implications for companies, their investors and customers'.[3]

ESG risks can present themselves at the level of an individual investment, at the portfolio level, or systemic level across a market.[4] RSE licensees should identify and account for the risks that could affect their investments over the whole investment horizon. It is important that APRA clearly recognises the financial materiality of ESG risks and the importance of managing them effectively, alongside all other forms of financial risk. Therefore,

[1] Investment Magazine, "APRA to review ESG matters", 1 May 2019.
[2] For example, a 2017 study by Nordea Equity Research reported that from 2012 to 2015, the companies with the highest MSCI ESG ratings outperformed the lowest-rated firms by as much as 40%. For other examples, see ACSI, 'Financial materiality and ESG', November 2020.
[3] Keynote address by ASIC Chair James Shipton, 'Launch of ASIC's report on director and officer oversight of nonfinancial risk', 2 October 2019.
[4] As illustrated, for example, in APRA's CPG 229 Climate Change Financial Risks.

clarification that investment risk and governance considerations include ESG factors (among other areas of risk) would be welcomed. Providing such clarification would promote consistency and alignment across APRA guidance and standards – for example CPG 511 (Remuneration) and CPG 229 (Climate change financial risks) - which make clear that effectively responding to environmental, social and governance risks is central to the prudent management of an entity.

Existing guidance in SPG 530 is not clear. For example, currently, SPG 530 confuses ethical investing and ESG integration. It is important to be clear on the distinction. Ethical investing attempts to balance the desire for returns with a fund member's values, by excluding investments that are inconsistent with those values (for example, excluding investments in tobacco, firearms or gambling). In contrast, ESG integration recognises that certain environmental, social and governance-related risks can be financially material, and therefore must be considered alongside traditional financial metrics (such as discount rates, cash flows, revenue, etc). ESG integration recognises that investments can perform better over the long term when ESG risks and opportunities are appropriately managed. It is important to make this distinction clear across APRA standards and guidance, recognising that ESG factors are central to prudential risk management.

We therefore recommend that APRA explicitly recognises that ESG risks are important factors to integrate into investment risk management.

I trust our comments are of assistance. Please contact me or [redacted], should you require any further information.

Yours faithfully

[redacted]

Chief Executive Officer
Australian Council of Superannuation Investors