



AUSTRALIAN INSTITUTE of  
SUPERANNUATION TRUSTEES

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Ms [REDACTED]  
Executive Director  
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Email: [REDACTED]

Dear [REDACTED]

### **Consultation on Prudential Standard SPS 530 Investment Governance in Superannuation**

**In brief:** AIST supports enhancements being made to SPS 530 Investment Governance but seeks that the standard better reflect appropriate governance of increasingly large and complex entities. For example, Board should endorse performance benchmark methodology and oversight performance, but can delegate consideration of each investment in each investment option.

APRA should also amend SPS 530 to clarify that investment risk and governance should include ESG factors, and update the guidance on consideration of ESG factors in formulating investment strategy.

AIST welcomes the opportunity to comment on APRA's revised prudential standard on investment governance practices. We recognise the desirability of reviewing the prudential standard at this time and support enhancements being made to valuation practices, stress testing and liquidity management practices.

Within the context of this overall support, AIST makes the following recommendations to further improve the regulation of superannuation investment governance:

1. Requirements for investment monitoring should clarify that while the Boards of RSE licensees should monitor investment performance including methodology and performance against benchmarks, detailed consideration of each investment in each investment option and each MySuper product can and should be delegated to management in accordance with the investment governance framework.
2. Paragraph 24 of SPS should be rewritten to state:

*An RSE licensee must determine appropriate measures approved by the Board, to monitor the performance of each investment in each investment option and each MySuper product, including the methodology for performance benchmarks, on an ongoing basis.*

3. The management and oversight of investment monitoring, liquidity risk, and the valuation governance framework should not necessarily require the establishment of a stand-alone Board committee for each area (although it may). Each RSE licensee should determine the governance processes, including delegated responsibilities, that best and most effectively meets the needs of their entity while acknowledging the Board's ultimate responsibility for these matters.
4. The formulation in proposed subparagraph 32(b) for determining roles and responsibilities for investment stress testing is appropriate for the increasing size and complexity of superannuation funds, and the increasing complexity of investment structures. This should be reflected for the roles and responsibilities for investment monitoring, liquidity risk and valuation governance.
5. There should be greater internal alignment (and consistent use of words and expressions) in SPS 530. If there are different governance requirements for investment monitoring, liquidity management, and valuation and stress-testing frameworks, this and the reasons for it should be made clear. Similarly, references to programs, plans, frameworks and policy documentation should be streamlined, or the differences between them explained.
6. The requirement for a valuation policy to include the validation of valuation outputs is contentious and should be the subject of further expert consultation by APRA.
7. APRA should advise the process and timeline to be followed for the review of previous exercises of discretion.
8. APRA has previously stated<sup>1</sup> that proposed enhancements in the review of SPS 530 will:
  - a. Clarify or strengthen the factors that RSE licensees are required to consider for member directed (choice) investment options; and
  - b. Review and update the guidance on consideration of ESG factors in formulating investment strategy

Given the importance of these issues to investment governance, and their absence in the current review, AIST calls upon APRA to address these apparent omissions as a matter of urgency, and to open up and extend the SPS 530 consultations accordingly. In particular, AIST strongly recommends SPS 530 clarifies that investment risk and governance should include ESG factors.

### **Investment monitoring must better reflect overall governance of large and complex entities**

#### **AIST recommendation**

Requirements for investment monitoring should clarify that, while the Boards of RSE licensees should monitor investment performance including the methodology and performance against benchmarks, detailed consideration of each investment in each investment option and each

<sup>1</sup> APRA, Information Paper: Review of APRA's 2013 superannuation prudential framework 30 April 2019, p.10. [https://www.apra.gov.au/sites/default/files/information\\_paper\\_review\\_of\\_apras\\_2013\\_superannuation\\_prudential\\_framework.pdf](https://www.apra.gov.au/sites/default/files/information_paper_review_of_apras_2013_superannuation_prudential_framework.pdf)

MySuper product can and should be delegated to management in accordance with the investment governance framework.

**AIST recommendation**

Paragraph 24 of SPS should be rewritten to state:

*24. An RSE licensee must determine appropriate measures approved by the Board, to monitor the performance of each investment in each investment option and each MySuper product, including the methodology for performance benchmarks, on an ongoing basis.*

AIST recognises that Boards are ultimately and rightly responsible for investment and other decisions, and strongly supports structures and processes support efficient and effective oversight. We also appreciate that management decisions must be carried out consistent with Board approved decisions, methodologies, and framework. However, overloading Boards with excessive and unnecessary details is not consistent with such an approach

The proposed change to the standard in relation to paragraph 24 is that:

*An RSE licensee must determine appropriate measures, including performance benchmarks, approved by the Board to monitor the performance of each investment in each investment option and each MySuper product on an ongoing basis."*

A literal reading of proposed paragraph 24 is that Boards must approve a performance benchmark for each investment in each investment option. AIST submits that this is neither appropriate, feasible (or even workable) nor indicative of good governance in the context of large and complex superannuation funds.

By way of example, one of our larger members currently holds around 450 investments with performance benchmarks and the approval of the appropriate performance benchmark for each of these investments best sits with their investment team, provided it aligns to the relevant sector performance benchmarks approved by the Investment Committee.

To require the Board to approve a performance benchmark for each investment would change the meaning, purpose and operation of the investment monitoring currently required under paragraph 24.

The current paragraph 24 requires Boards to approve measures to monitor performance across all of the assets within the RSE's products. This requirement is met by reports made by management to Boards that demonstrate that appropriate measures are in place, for consideration and approval by Boards.

This does not require Boards to consider and approve a performance benchmark for each investment in each investment option, although this may be done in specific cases if circumstances or trustee delegations require it.

The existing SPG 530 already identifies the role of benchmarks. For example:

*104. APRA expects that an RSE licensee's monitoring process would use appropriate pre-determined benchmarks and/or performance measurement criteria to evaluate investments and investment managers.*

AIST supports the approach in the existing SPG 530 and notes that these processes and measurements may occur using appropriate delegation to management, with appropriate governance oversight. AIST understands and supports the intention of increasing the Board's visibility in relation to benchmarks but submits this should be manifest in consideration of the methodology for performance benchmarks. This, rather than focussing on individual benchmarks for each investment in each investment option, is the best and most efficient way of ensuring the Board maintains oversight of investment governance.

This is particularly important given the increasing size and complexity of superannuation funds, the increasing complexity of investment structures, and the now widespread employment of specialist investment professionals.

To load the Board of a large superannuation fund with the requirement to individually assess and approve the benchmark for of each investment in each investment option would require an inordinate amount of the time of trustees, distract and distort the RSE's consideration of the wide range of matters requiring trustee consideration, and not make full and appropriate use of investment committees, investment professionals and other managers. This would not be in the best interests of the members of the fund nor the efficient operation of the fund.

This was recognised in APRA's summary of findings about SPS 530 in its 2019 [Information Paper: Review of APRA's 2013 superannuation prudential framework](#)

*The complexity that exists in the investment structures across the different business models operating in the superannuation industry needs to be better reflected in the standard and/or guidance.*

This is also the approach taken under existing SPG 530:

*112. SPS 530 requires the monitoring of investment performance to be reported to the Board and senior management. APRA expects the frequency and style of an RSE licensee's performance reporting to be dependent on the type, complexity, and amount of investment, and sufficient to satisfy the RSE licensee that it has adequate oversight of the investment.*

AIST also submits that a specific requirement for ongoing consideration of performance benchmarks for each investment in each investment option by the Board would not be in the interests of obtaining the best investment returns for members. This is because, the process would slow and render cumbersome investment decision-making by the fund. Quick, agile and reviewed investment decision-making is important in ensuring the best invest outcomes for members.

It is not however reflected in the construction of paragraph 24.

In the alternative, AIST proposes the following construction of paragraph 24 that identifies the role of Boards in relation to performance benchmarks:

*24. An RSE licensee must determine appropriate measures approved by the Board, to monitor the performance of each investment in each investment option and each MySuper product, including the methodology for performance benchmarks, on an ongoing basis.*

This construction also raises consideration of performance benchmarks to Board level but leaves appropriate room for detailed consideration of individual benchmarks and performance against those benchmarks by investment professionals as determined by the Board. Under this approach, the Board would continue to monitor performance, determine the methodology for performance benchmarks and consider the fund's investment governance framework and performance against that framework on an ongoing basis.

### **Stress testing**

AIST recognises that new investment risks can quickly change, and that RSE licensees must be well-positioned to withstand a severe economic and investment downturn, while still maintaining their obligations to fund members.

The Covid crisis is evident of this, as is the generally flexible and fast response of licensees to the crisis, including management of the outflows resulting from the Early release of Superannuation scheme.

RSE licensees already undertake rigorous stress-testing, but AIST agrees that the more detailed investment stress testing requirements proposed for SPS 530 will assist and challenge RSE licensees to respond to extraordinary circumstances in the future.

The proposed requirements set out in subparagraph 32(b) for a comprehensive investment stress-testing program to include the roles and responsibilities of persons (both internal and external) involved in the design, implementation, review, reporting and oversight of investment stress testing, including the role of the Board, relevant Board committees and senior management recognises the range and complexity of RSE structures and personnel.

This is a formulation that is appropriate for the increasing size and complexity of superannuation funds, and the increasing complexity of investment structures, and should be reflected for the roles and responsibilities for investment monitoring and valuation governance.

### **Liquidity management**

#### **AIST recommendations**

Each RSE licensee should determine the governance processes, including delegated responsibilities, that best and most effectively meets the needs of their entity, while ensuring the Board management.

AIST proposes that the language in proposed sub-paragraph 35(f) be aligned to that used in sub-paragraph 32(b) in relation to stress testing and read:

*includes the roles and responsibilities of persons (both internal and external) involved in the design, implementation, review, reporting and oversight of liquidity risk management, including the role of the Board, relevant Board committees and senior management;*

Managing liquidity risk became a priority during the early stages of the pandemic, and RSE licensee liquidity concerns were accentuated by the Early Release of Superannuation scheme. These concerns abated during 2020 in part because of the soundness of existing SPS 530. We agree with APRA's conclusion that:

*This outcome strongly reflects the improvements made by trustees since the GFC, particularly improvements in liquidity risk management practices to address the enhanced requirements of APRA's Prudential Standard SPS 530 Investment Governance (SPS 530), which was introduced in 2013. These changes enabled trustees to have a better understanding of their drivers of liquidity risk, and a planned approach to improve liquidity in circumstances where liquidity demands were significantly increased.*

Nonetheless, AIST also agrees that the prudential framework should be subject to a process of continuous improvement, and that it is now appropriate for SPS 530 to now also prescribe that an RSE licensee's liquidity management plan must:

- identify personnel responsible for the management and oversight of liquidity risk;
- include liquidity stress testing as part of their comprehensive stress testing program; and
- outline key metrics to be reported to and periodically reviewed by the Board, relevant board committees and senior management.

However, sub-paragraph 35(f) and (g) should not be read as requiring the establishment of a stand-alone Board liquidity risk management committee. While this is probably not the intention, this should be made clear.

Each RSE licensee should determine the governance process that best and most effectively meets their needs. That is, delegated responsibilities for the oversight and management of liquidity issues may be given to Board committees, senior management, and investment professionals.

AIST proposes that the language in proposed sub-paragraph 35(f) be aligned to that used in sub-paragraph 32(b) in relation to stress testing and read:

*includes the roles and responsibilities of persons (both internal and external) involved in the design, implementation, review, reporting and oversight of liquidity risk management, including the role of the Board, relevant Board committees and senior management;*

## Valuation governance framework

### AIST recommendations

The management and oversight of the valuation governance framework should not necessarily require the establishment of a stand-alone Board committee, and each RSE licensee should determine the governance processes, including delegated responsibilities, that best and most effectively meets the needs of their entity.

AIST proposes that the language in proposed sub-paragraph 39(a) be aligned to that used in sub-paragraph 32(b) in relation to stress testing and read:

*includes the roles and responsibilities of persons (both internal and external) involved in the design, implementation, review, reporting and oversight of valuation processes, including the role of the Board, relevant Board committees and senior management;*

The requirement for a valuation policy to include the validation of valuation outputs is contentious and should be the subject of further expert consultation by APRA.

AIST supports moves by APRA to improve the asset valuation practices throughout the superannuation industry, including the elevation of some guidance from the relevant prudential practice guide into proposed SPS 530.

Specifically, AIST supports the proposed requirements for RSE licensees to establish a valuation governance framework to identify and manage valuation risk, with a Board-approved valuation policy.

However, we do not read sub-paragraph 39(a) as necessarily requiring the establishment of a stand-alone Board valuation committee. While this is probably not the intention, this should be made clear.

Similarly, paragraphs 38 to 40 could also be read as requiring the valuation governance framework to be separate and distinct from the RSE's investment governance framework. It should be open to RSEs to design the valuation governance framework as a component part of its investment governance framework where it would be appropriate and in members best interests to do so, or for it to stand alone.

In contrast, paragraph 29 sets out the requirement to have a stress testing program that "is integrated into the RSE licensee's IGF." It is not clear why there is a different requirement in relation to valuation requirements, and submits that it need not be.

Each RSE licensee should determine the governance process that best and most effectively meets their needs. That is, delegated responsibilities for the oversight and management of valuation processes and procedures may be given to Board committees, senior management, and investment professionals; and governance frameworks that can be integrated.

AIST proposes that the language in proposed sub-paragraph 39(a) be aligned to that used in sub-paragraph 38(a) in relation to stress testing and read:

*includes the roles and responsibilities of persons (both internal and external) involved in the design, implementation, review, reporting and oversight of valuation processes, including the role of the Board, relevant Board committees and senior management.*

The requirement for a valuation policy to include the validation of valuation outputs including any back-testing procedures (sub-paragraph 39(i)) should be the subject of further expert consultation by APRA. Expecting or requiring RSEs to do their own valuation calculations to validate those provided by independent experts, and then potentially change the independent valuations, is fraught and contentious. This should be the subject of further consideration.

#### **Clarify process to review previous exercises of discretion**

##### **AIST recommendation**

APRA should advise the process and timeline to be followed for the review of previous exercises of discretion.

AIST understands that APRA reviews the exercise of discretions under the previous versions of prudential standards. In relation to the proposed changes to SPS 530, AIST seek that APRA advise the process and timeline to be followed for the review process.

#### **Member-directed investments and consideration of ESG factors should be addressed**

##### **AIST recommendation**

APRA has previously stated that the review of SPS 530 will:

- a. Clarify or strengthen the factors that RSE licensees are required to consider for member directed (choice) investment options; and
- b. Review and update the guidance on consideration of ESG factors in formulating investment strategy

In the absence of these matters in the current review, AIST calls upon APRA to address these apparent omissions as a matter of urgency, and to open up and extend the SPS 530 consultations accordingly.

APRA's [Information Paper: Review of APRA's 2013 superannuation prudential framework](#) also foreshadowed proposed enhancements to SPS 530 for:

- *Clarifying or strengthening the factors that RSE licensees are required to consider for member directed (choice) investment options.*
- *Considering additional guidance or requirements to enhance the application of investment strategy stress testing.*
- *Reviewing and updating the guidance on consideration of ESG factors in formulating investment strategy.*



APRA also released a statement that it plans to update the guidance on consideration of ESG factors in formulating investment strategy.

*With regard to ESG, enhancement to the investment governance standard (SP530) and guidance could be considered to reflect global developments in this area and provide clarity on the obligations of RSE licensees to take into account ESG factors when setting their investment strategies<sup>2</sup>.*

While the proposed changes to SPS 530 address stress testing, there is no reference to member-directed investments nor consideration of ESG factors.

While APRA has recently finalised its prudential practice guide CPG 229 Climate Change Financial Risks, other ESG considerations remain unaddressed.

APRA previously indicated it would consider feedback on alignment between the final CPG 229 and SPS 530 as part of its proposed enhancements to that material, but this is not identified as an issue in the current consultation. If it is intended to address these in the subsequent review of SPG 530, APRA should identify this.

However, it should also include high-level statements of expectation in SPS 530 about consideration of ESG factors in formulating investment strategies. This is particularly important given the increasing focus on non-financial risk.

In order to act in members best financial interests, investors consider the ESG risks in their investments, and so SPS 530 must recognise the importance of managing ESG risks, alongside all other forms of risk. AIST strongly recommends that SPS 530 clarifies that investment risk and governance should include ESG factors.

AIST calls upon APRA to address these apparent omissions as a matter of urgency, and to open up and extend the SPS 530 consultations accordingly.

For further information regarding our submission, please contact [REDACTED]

[REDACTED] at [REDACTED]

Yours sincerely,

[REDACTED]

[REDACTED]  
**Chief Executive Officer**

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<sup>2</sup> Reported in Investment Magazine, 1 May 2019 "[APRA to review ESG matters](#)"

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