



APRA

# PRUDENTIAL PRACTICE GUIDE

## SPG 530 Investment Governance

Integrated version

July 2023

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# About this guide

Prudential practice guides (PPGs) provide guidance on APRA’s view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA’s prudential standards, but do not themselves create enforceable requirements.

*Prudential Standard SPS 530 Investment Governance* (SPS 530) sets out APRA’s requirements in relation to investment governance for an RSE licensee’s business operations.

This PPG, *Prudential Practice Guide SPG 530 Investment Governance* (SPG 530), provides guidance to RSE licensees in the formulation, implementation, maintenance and oversight of an investment strategy. It sets out prudent practices in relation to investment risk management arrangements to assist an RSE licensee in ensuring it:

- clearly articulates what its investments are designed to achieve and how this supports the delivery of member outcomes;
- has the capability and capacity to select and manage investments and associated risks; and
- has a clear, objective, operationally independent and robust performance assessment framework.

Subject to the requirements of SPS 530, an RSE licensee has the flexibility to structure its business operations in the way most suited to achieving its business objectives. Not all practices outlined in this PPG will be relevant for every RSE licensee and some aspects may vary depending upon the size, business mix and complexity of the RSE licensee’s business operations.

The graphic below summarises APRA’s prudential framework, and shows where SPG 530 fits in, within the *business operations pillar*.

Prudential framework				
Governance	Risk management	Business operations*	Recovery and resolution	Reporting
Act with honesty, integrity, due skill, care and diligence	Maintain effective risk management strategies and systems	Maintain adequate financial resources	Adequately prepare for stress	Reliable reporting
Core standard (SPS 510)	Core standard (SPS 220)	Core standard (SPS 515)	Core standards (CPS 190, CPS 900)	Core standards
Supporting standards	Supporting standards	Supporting standards (SPS 114, SPS 160, SPS 250, SPS 530)	Supporting standards	Supporting standards
Guidance	Guidance	Guidance (SPG 515, SPG 516, SPG 114, SPG 160, SPG 250, SPG 270, SPG 280, SPG 530)	Guidance (CPG 190, CPG 900)	Guidance

\* For ADIs and insurers, this category is Financial resilience.

This integrated version of SPG 530 maps APRA's guidance to the relevant paragraphs in SPS 530. Paragraphs from SPS 530, which are enforceable requirements, have been set out in blue boxes like this; the accompanying guidance follows outside the blue boxes.

# Glossary

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<b>APRA</b>	Australian Prudential Regulation Authority
<b>Climate risk</b>	Financial risks arising from climate change, consistent with CPG 229, including physical (both acute risks associated with extreme weather events and chronic risks associated with gradual shifts in climate), transition and liability risks.
<b>CPG 229</b>	<i>Prudential Practice Guide CPG 229 Climate Change Financial Risks</i>
<b>ESG factors</b>	Either qualitative or quantitative environmental, social and governance factors that may affect the risk-return profile of investments through their impact on assets, companies, industries, or markets generally.
<b>Investment option</b>	An investment that an RSE licensee makes available to beneficiaries to select. It may comprise a mix of investments selected by an RSE licensee, investment in an externally managed investment option, investment in a lifecycle strategy, or a direct investment in one asset, such as an individual listed security, term-deposit or bond.
<b>Lifecycle strategy</b>	A strategy that varies the asset allocation for beneficiaries according to the member's age and/or other prescribed factors in r. 9.47, <i>Superannuation Industry (Supervision) Regulations 1994</i> . It is represented by a 'glidepath' which is the transition of the asset allocation targets over the course of the lifecycle investment strategy.
<b>PPG</b>	Prudential practice guide
<b>Risk budgeting</b>	Risk budgeting considers how different risks drive the returns of different asset classes and derives the optimal asset allocation based on the expected return per unit of risk of each of those asset classes.
<b>RSE</b>	Registrable superannuation entity as defined in s. 10(1) of the <i>Superannuation Industry (Supervision) Act 1993</i> .
<b>RSE licensee</b>	As defined in s.10(1) of the <i>Superannuation Industry (Supervision) Act 1993</i> .
<b>SIS Act</b>	<i>Superannuation Industry (Supervision) Act 1993</i>
<b>SPS 530</b>	<i>Prudential Standard SPS 530 Investment Governance</i>

# The role of the board

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## Board responsibility

7. An RSE licensee is ultimately responsible for the sound and prudent management of the investments of each RSE within the RSE licensee's business operations.
  8. The Board of an RSE licensee (the Board) must, for the RSE licensee's business operations, at a minimum:
    - a) approve investment objectives for each investment option offered in each RSE;
    - b) approve an investment strategy, in respect of each RSE, that is consistent with the RSE licensee's duties to beneficiaries, including those in section 52(6) and (13) (if applicable) of the SIS Act and the requirements in this Prudential Standard:
      - i. for the whole of that RSE; and
      - ii. in respect of each investment option offered in that RSE;
    - c) monitor and assess regularly whether the investment objectives are being met; and
    - d) take appropriate and timely action regarding information contained in reports to the Board on investment matters.
1. An RSE licensee's Board (the Board) is ultimately responsible for ensuring its governance of investments supports effective investment decisions that deliver quality retirement outcomes for beneficiaries that are consistent with the strategic direction of each RSE within the RSE licensee's business operations.
  2. An effective Board balances the need to provide review and challenge of key investment decisions, with an appropriate delegation framework that allows the Board to maintain visibility, knowledge and appropriate control and oversight of the exercise of delegations.
  3. The Board would be able to demonstrate that it has:
    - a) an appropriate mix of investment-related skills and expertise;
    - b) clearly documented delegations that consider the roles and decision-making responsibilities within the RSE licensee, ensuring segregation of duties between those implementing investment decisions and those reviewing performance and risk outcomes;
    - c) access to external experts and their advice, views and insights to support the Board fulfilling its obligations under SPS 530, as required; and
    - d) appropriate oversight and reporting mechanisms.

4. When considering the appropriate level of Board oversight of investments, APRA expects the Board would be able to demonstrate how it effectively governs the number and complexity of investment decisions and ensures an appropriate non-executive assessment of investment decisions.
5. APRA expects an RSE licensee would consider establishing a Board committee, such as a Board Investment Committee, to support the Board. It is important that the governance arrangements for such committees are well considered and documented in a charter or terms of reference, to ensure appropriate membership with expertise, diversity and the necessary resources to support its effective function.

## RSE licensee that are part of a group

9. Where an RSE licensee is part of a corporate group, and the RSE licensee utilises group policies or functions, the Board must approve the use of group policies and functions and must ensure that these policies and functions give appropriate regard to the RSE licensee's business operations.
6. The use of group policies may enable an RSE licensee to operate in a manner that is consistent with the group. When approving the use of group policies, a Board would demonstrate why it considers the policies to be appropriate to deliver outcomes to beneficiaries, including how conflicts between RSE licensee policies and group policies are to be managed, in accordance with the requirements of *Prudential Standard SPS 521 Conflicts of Interest*, as well as how the Board will be engaged in the process of reviewing these policies over time.



# Investment governance framework

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## Establishing the framework

10. An RSE licensee must at all times have an investment governance framework to manage investments to meet the RSE licensee's obligations to beneficiaries.
  11. An investment governance framework is the totality of systems, structures, policies, processes and people to address the RSE licensee's responsibilities with regard to investments of each RSE within the RSE licensee's business operations. An RSE licensee's responsibilities include generating returns to meet investment objectives while managing and monitoring all identified sources of investment risk.
  12. The Board is ultimately responsible for the establishment, implementation, oversight and maintenance of an RSE licensee's investment governance framework.
7. APRA expects the Board would demonstrate how it understands, in a practical way, its role in the investment governance framework and how it ensures that appropriate approvals to changes in the framework are managed.
  8. APRA expects the Board would provide clear strategic investment direction, including the setting of investment objectives and investment strategies. The Board would also demonstrate their involvement in the implementation of the investment governance framework, including how it goes about making key investment decisions and reviewing and challenging key investment reports to support oversight.

## Member equity considerations

9. APRA expects an RSE licensee's investment governance framework would appropriately consider member equity risk with a view to all beneficiaries being dealt with fairly. Such considerations include:
  - a) ensuring beneficiaries transact at fair prices across all investment options, which may include, for example, implementing a blackout period for transacting in the option around expected asset revaluation periods;
  - b) establishing processes for the monitoring and quantification of equity impacts arising from material events on a cost-benefit basis, such as interim valuation of assets, liquidity provider arrangements and beneficiary transactions; and
  - c) monitoring arrangements, particularly for single sector investment options where the revaluation and liquidity impacts are amplified due to the greater concentration of exposures.

## Investment operating model

10. APRA expects an RSE licensee would determine the most appropriate investment operating model to support the implementation of its investment governance framework,

with this operating model reviewed as needed to reflect changes in the RSE licensee's business operations. APRA expects this decision would be clearly documented, demonstrating how the investment operating model is appropriate with reference to the size of the RSE licensee's operations and complexity of its investments.

11. Where an RSE licensee operates some, or all, of its investment functions internally, APRA expects an RSE licensee would be able to demonstrate that it has systems, resources and processes that support the appropriate management of risk commensurate with services provided by highly-skilled external service providers.
12. When deciding to manage some, or all, of its investment functions internally, an RSE licensee would determine, inter alia:
  - a) the governance model, including appropriate delegations, for overseeing the internal investment management function;
  - b) the ongoing monitoring and management of performance and risk outcomes, particularly where under-performance is identified;
  - c) how it will attract, retain and remunerate appropriately skilled investment staff and manage potential cultural changes;
  - d) how it will manage exposure to potential internal errors and operational deficiencies;  
and
  - e) the cost-benefit analysis of moving to either a fully internalised or hybrid model.

## The investment governance framework

13. An RSE licensee's investment governance framework must, at a minimum, include:
  - a) investment objectives for each investment option offered by the RSE licensee;
  - b) a methodology for determining investment reporting measures;
  - c) the investment strategy for the whole of each RSE and for each investment option as required by section 52(6) of the SIS Act;
  - d) all Board policies relating to investment activities;
  - e) role statements that include the details of each role's responsibilities and reporting structures for all roles related to investment activities;
  - f) structures, policies and processes relating to investment activities, including for investment performance and risk measurement, assessment, stress-testing, valuations and reporting to the Board and senior management; and
  - g) a review process to ensure that the investment governance framework remains effective.
14. An RSE licensee's investment governance framework must be appropriate to the size, business mix and complexity of the RSE licensee's business operations.
15. An RSE licensee must have procedures to ensure that all persons in roles related to investment activities of the RSE licensee are made aware of, and have processes and controls for monitoring compliance with, the RSE licensee's investment governance framework.

### Roles and responsibilities

13. It is important that an RSE licensee clearly articulates the roles and responsibilities of senior management and/or external service providers and any delegated authorities across the range of investment functions, with these reviewed at least annually to ensure they remain appropriate and the personnel conducting these functions have both capacity and capability to exercise their responsibilities. APRA expects that, in addition to annually reviewing roles and responsibilities, the RSE licensee would also undertake a review when there are any significant changes to resources.
14. An RSE licensee would be able to demonstrate clear and distinct roles and responsibilities for the range of investment functions that are performed, including, but not limited to:
  - a) articulating roles and responsibilities and how these might vary under normal and stressed operating conditions;
  - b) clearly identifying decision makers consistent with the RSE licensee's delegation framework;

- c) ensuring roles with responsibility for review are undertaken by persons independent of those performing the functions; and
  - d) ensuring the roles and responsibilities are updated over time to reflect material changes in investment strategy, investments, organisational structure or the external environment.
15. An RSE licensee would assess, at least annually, the level of skills and experience of available personnel with respect to particular investments/asset classes and investment risks to identify and manage any gaps in capability.

### **Structures, policies and processes**

16. An RSE licensee would be able to demonstrate that the structure, policies, and processes are appropriate for its investment operating model and support adequate separation of duties and reporting lines.
17. APRA expects:
- a) that oversight functions relating to performance monitoring, valuation, and unit pricing would be independent from those that make or can influence investment decisions and outcomes; and
  - b) investment risk objectives would be monitored and managed objectively, separating persons responsible for making and/or implementing investment decisions and those responsible for investment risk management arrangements. This includes risk measures, limits and tolerances, and reporting used to monitor investment department activities.
18. An RSE licensee would ensure that policies and process are reviewed and updated over time to reflect changes to operations and practices as they occur.

## **Review of the investment governance framework**

16. An RSE licensee must ensure that the appropriateness, effectiveness and adequacy of its investment governance framework are subject to a comprehensive review by operationally independent, appropriately trained and competent persons at least every three years.
17. The scope of the review of an RSE licensee's investment governance framework must have regard to the size, business mix and complexity of the RSE licensee's business operations, the extent of any change to those operations and any changes to the external environment in which the RSE licensee operates.
19. A prudent RSE licensee would ensure that the triennial comprehensive review of the investment governance framework encompasses all components of the framework, including, but not limited to:
- a) oversight of the framework;

- b) the appropriateness of delegations and accountabilities;
  - c) the necessary skills and experience of personnel;
  - d) the effectiveness of process and systems;
  - e) the effectiveness of investment and liquidity risk management arrangements;
  - f) the effectiveness of the framework in implementing the investment risk appetite and identifying new risks; and
  - g) all relevant policies and procedures.
20. APRA expects an RSE licensee would have in place a process to ensure that the investment governance framework is comprehensively reviewed every three years.
21. Components of the framework may need to be reviewed out of cycle to reflect changes in the RSE licensee's business operations and emerging best practice, and to ensure the framework remains current and effective.
22. A prudent RSE licensee would ensure that all findings of the triennial comprehensive review are addressed in a timely manner, with appropriate persons accountable for their delivery and priority given to any key deficiencies identified.

# Formulating the investment strategy

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## Investment objectives

18. An RSE licensee must, when formulating the investment strategy for each investment option, set investment objectives that are:
- a) aligned with the size, business mix and complexity of the RSE from which the investment option is offered; and
  - b) specific and measurable and, at a minimum, include:
    - (i) a return objective; and
    - (ii) a risk objective.
23. Investment objectives provide a measurable target for RSE licensees to consider performance, parameters for investing assets and valuable information to assist beneficiaries to select the investment options appropriate to their needs. It is, therefore, important that investment objectives are clearly and consistently explained, with reference to a range of quantifiable metrics over clear time horizons.
24. As investment risk can be particularly challenging for beneficiaries to interpret and understand, an RSE licensee would consider how to articulate investment risk objectives to enhance member understanding of investment risk. This may include how risk appetite tools and qualitative statements support traditional quantitative metrics, for example, *no more than x negative investment returns in a period of y years*.
25. APRA expects an RSE licensee that applies screens or filters to potential investments would clearly document how such screens or filters accord with its investment philosophy and clearly communicates to beneficiaries the potential effect of these screens.

## Formulating the strategy

19. When formulating each investment strategy for the whole of the RSE, and for each investment option, an RSE licensee must document how it has regard to each of the factors in section 52(6) of the SIS Act.
26. To support the formulation of the investment strategy, APRA expects an RSE licensee would consider clearly articulating an investment philosophy, including the extent to which environmental, social and governance (ESG) considerations inform that philosophy. This can help to provide a clear statement to beneficiaries and other key stakeholders by providing longer term guiding principles for investment decision-makers.

## Lifecycle investment strategy

27. A lifecycle investment strategy is typically characterised by a sequence of separate 'lifestages'. An RSE licensee would ensure that development, implementation and assessment of a lifecycle strategy is considered at the overall glidepath and individual stage level.
28. APRA expects that an RSE licensee would formally document its assumptions and considerations in determining the glidepath and the respective stages within the lifecycle strategy.
29. When determining the appropriate glidepath design and stages of a lifecycle strategy, an RSE licensee would consider matters such as:
  - a) its membership demographic profile;
  - b) factors that will determine the strategic asset allocation for a member to achieve retirement income goals;
  - c) the optimal number of lifestages;
  - d) the relevant investment time horizon for the entirety of the lifecycle strategy;
  - e) the glidepath structure to be adopted;
  - f) the availability of post-retirement products offered by the RSE licensee; and
  - g) the structure of the drawdown phase.
30. An RSE licensee would determine the investment risk appetite and objectives appropriate at each stage in the lifecycle investment strategy. The investment objectives would be consistent with the overarching lifecycle investment objective.
31. APRA expects an RSE licensee would determine the asset allocation target and ranges for each lifestage. When doing so, an RSE licensee may consider the trade-off between risk appetite and the investment horizon, which drives the portfolio risk exposures in the final years before retirement. APRA considers market volatility just before and after a member's retirement to be particularly critical to outcomes. Other considerations include asset class selection, rebalancing processes and the liquidity of the investment strategy at each lifestage.
32. When formulating a lifecycle investment strategy and glidepath, an RSE licensee would also consider the risks associated with implementation.

## Derivatives

33. An RSE licensee would establish a formal policy to govern the permitted range and use of derivatives, demonstrating how the use of derivatives is consistent with investment objectives and establishing mechanisms to capture, monitor and manage potential risks associated with the use of derivatives.

34. An RSE licensee would have effective mechanisms to identify and capture, monitor and manage the potential risks associated with the use of derivatives that are commensurate with the nature and complexity of derivative exposures within the investment strategy. These may include liquidity risk, basis risk, rollover risk and counterparty risk.
35. APRA expects that an RSE licensee would have formal, documented limits to ensure that risks arising from derivative exposures are managed within its established risk tolerances.
36. APRA expects that an RSE licensee would receive regular and timely reporting on its derivative exposures, together with details regarding any mandate breaches when appropriate.
37. An RSE licensee's due diligence would also review the internal control structure of the external investment manager to ensure that all derivative risk exposures are being appropriately monitored, mitigated and managed.

### **Currency exposures**

38. An RSE licensee would demonstrate how it manages potential risks arising from foreign currency exposures, including setting target currency exposures or hedge ratios, the approach to rebalancing and the monitoring and reporting on foreign currency exposures.
39. An RSE licensee would have mechanisms that adequately address the potential risks arising from foreign currency exposures within its investment strategy.
40. Policy documentation would outline an RSE licensee's approach to the management of currency exposure, including a framework for setting target currency exposures or hedge ratios, the approach to rebalancing and the roles and responsibilities.
41. APRA expects that an RSE licensee would establish regular reporting on the management of foreign currency exposures. Such reporting would typically include the current foreign currency exposures within the investment option, the contribution to investment returns, hedge effectiveness and counterparty exposures.
42. APRA expects that an RSE licensee would also monitor the liquidity impact of maintaining a hedging strategy for each investment option. It would be prudent for an RSE licensee to assess the impact that any sudden or significant movement in exchange rates may have on the liquidity position of each investment option.



## Risk factor considerations

20. An RSE licensee must, when determining an appropriate level of diversification for each investment strategy:
- a) identify the risk factors, and sources of return with which the risk factors are associated;
  - b) where the strategy includes multiple assets and/or asset classes, identify how sources of returns are expected to interact, the variability in these interactions and the impact of these interactions on the overall diversification of the strategy in different market conditions;
  - c) determine the target exposure to the risk factors in paragraph 20(a); and
  - d) determine the asset classes and/or individual assets that it will invest in to achieve the desired risk exposure and whether making, holding and realising investments in those asset classes and/or individual assets can be implemented in a manner consistent with the interests of, and the RSE licensee's duties to, beneficiaries.

43. APRA expects an RSE licensee would demonstrate how each investment option (including single asset class options) achieves appropriate diversification to support long-term investment goals while minimising risk.

### Investment risk

44. It is important that an RSE licensee consider how various types of investment risk (for example, market risk, liquidity risk, climate risk, concentration risk) can manifest through their chosen investment strategy, how such risks can adversely affect investment outcomes for beneficiaries and the extent to which the risk can be managed. APRA expects an RSE licensee would undertake a formal investment risk assessment to assist in identifying and establishing:

- a) investment risk factors and their potential impact on investment returns;
- b) investment risk mitigation strategies; and
- c) methods for monitoring and reporting on investment risk factors.

45. An RSE licensee would demonstrate how the investment risk assessment has informed the investment strategy and is consistent with appetite and tolerances for investment risk exposures. APRA expects that the key findings would be subject to dedicated discussion with the Board and Board committee, where relevant.

### ESG investing and risk factors

46. APRA expects an RSE licensee would demonstrate an understanding of the risk and opportunities present in a range of ESG factors, and the extent to which they may have an

impact on the financial risk-return profile of the RSE licensee's investment portfolio, including an assessment of climate risk exposures.

47. An RSE licensee would demonstrate how risk considerations connected to ESG factors are integrated into investment analysis, decision making and oversight, ensuring that the appropriate resources are available to identify and respond to material ESG factors. Where an RSE licensee determines that such risk considerations are financially material, it would demonstrate how this is reflected in the investment strategy and document how the risks will be managed.
48. APRA expects an RSE licensee would articulate the particular risk considerations connected to ESG factors that affect the portfolio and how these are reflected in terms of return and risk objectives.
49. An RSE licensee may incorporate objectives from investments, such as environmental or social impact related objectives, where it can demonstrate that pursuing such additional objectives is consistent with the outcomes the RSE licensee seeks to provide to beneficiaries.
50. Where investments are linked to objectives, such as environmental or social impact related objectives, APRA expects an RSE licensee would be able to demonstrate how it monitors the objectives, using recognised industry criteria.
51. APRA expects an RSE licensee would consider how it uses its influence or investment market presence, including engaging with investees, making public statements, undertaking policy advocacy and voting, to generate value in investments. Where an RSE licensee engages in such stewardship activities as part of its prudent management of investments, APRA expects an RSE licensee would be able to demonstrate how these activities:
  - a) contribute to value creation/preservation over different time horizons and support delivering financial returns to beneficiaries;
  - b) are appropriate in the context of the RSE licensee's business operations, resources and investment mix and complexity;
  - c) are undertaken on a cost-effective basis, including where undertaken by way of a collective approach; and
  - d) are aligned with publicly disclosed statements on stewardship.

## Asset allocation

21. An RSE licensee must, at a minimum, determine for each investment strategy for an investment option that includes multiple assets and/or asset classes:
- a) asset allocation targets and ranges that are appropriate to the investment objectives of the investment option;
  - b) the basis on which asset allocation targets and ranges would be changed; and
  - c) a policy to monitor and maintain the asset allocation within the determined ranges within a reasonable timeframe.

52. APRA expects an RSE licensee would be able to demonstrate:

- a) how the asset classes are expected to optimise returns for beneficiaries, provide appropriate diversification and align with investment risk objectives; and
- b) the range of permissible investments for the option, including any investment restrictions and how they reflect the RSE licensee's investment philosophy.

53. APRA expects an RSE licensee's asset allocation targets and ranges would be:

- a) informed by the investment philosophy;
- b) appropriate to achieving investment objectives; and
- c) supported by a clear and documented methodology that is underpinned by appropriate assumptions that are reviewed at least annually. This would include, but are not limited to, the RSE licensee considering how the methodology avoids overreliance on historical data and trends, achieves variation in asset class characteristics over time and responds to the challenges of modelling unlisted or illiquid assets.

54. Where an RSE licensee implements investment portfolio positions away from strategic positions to either manage risk or generate excess returns, APRA expects portfolios would be managed in accordance with a specific and formal policy that covers permitted ranges, internal reporting (including to the Board and Board committee, where relevant) and a review and approval process for making changes to the asset allocation.

### Modelling the asset allocation

55. Where an RSE licensee uses modelling to determine its asset allocation, the RSE licensee would be expected to demonstrate that it has sufficient expertise in evaluating any model-driven recommendations to determine whether further analysis prior to investment decisions being made is required. It is important that an RSE licensee understands the strengths and weaknesses of any modelling approach and the underlying methodology employed.

56. APRA expects an RSE licensee would have a formal policy to determine and review the methodology and assumptions underlying such models, which considers the potential variation in asset class characteristics over time, including expected returns, risk exposures and interactions between asset classes. This approach would also consider the risks of over-reliance on historical data when determining model assumptions. An RSE licensee would particularly consider the modelling of unlisted or illiquid investments.

### **Risk budgeting**

57. An RSE licensee may consider risk budgeting to better understand and determine:

- a) the nature and quantum of risks underlying the proposed asset class;
- b) the appropriate amount of risk to be taken;
- c) how the risk would be allocated in the investment strategy (e.g. asset class, sub-asset class or sector); and
- d) the returns that can be expected for taking a certain amount of risk.

58. An RSE licensee using a risk budgeting approach would review the impact of market movements on its risk allocation and the subsequent implications for the asset allocation of an investment option.

# Giving effect to the investment strategy

## Selection processes

23. An RSE licensee must have processes and criteria for selecting each investment to give effect to the investment strategy (investment selection process) to ensure that effective due diligence that is commensurate with the nature and characteristics of the investment is undertaken prior to the selection of an investment for an investment option.
24. An RSE licensee's investment selection process must enable the RSE licensee to ensure:
  - a) it has sufficient understanding and knowledge of the investment selected, including an assessment of any factors that could have a material impact on achieving the investment objectives of the investment option;
  - b) it has sufficient understanding of how the investment is expected to perform under the range of stress scenarios determined under paragraph 31; and
  - c) the investment is appropriate for the investment option.

## Due diligence

59. Effective due diligence is critical, in both the context of direct investments and the selection of investment managers, in selecting investments to deliver outcomes to beneficiaries.
60. APRA expects an RSE licensee would have sufficient resources to undertake due diligence commensurate with the size, nature, and complexity of the investments. For example, direct investment in an asset necessitates an understanding of the complexity and risk exposures of the asset, whereas offering an externally managed investment option involves understanding the asset allocation and underlying investments of that option.
61. APRA expects an RSE licensee would undertake appropriate analysis, including consideration of the impact of ESG factors on expected returns. A prudent RSE licensee would also demonstrate how the opportunity aligns with the overall investment strategy and satisfies the investment objectives.
62. APRA expects an RSE licensee would be able to demonstrate how its due diligence process:
  - a) for **investments**:
    - i) assesses projected performance and the impact of fees (including performance-based fees), risk factors, liquidity, valuation methodology, transaction costs and

the current and expected market conditions for the relevant industry for that investment;

- ii) incorporates the minimum standards which an RSE licensee expects an investee entity to adhere to, including ESG considerations; and
  - iii) **for unlisted assets:** covers ownership structure including information regarding Board membership and senior personnel, the business plan of the organisation, financial analysis of any private market for the investment, any future commitments required and any restrictions that limit the ability to exit the investment; and
- b) **for investment managers:** assesses investment manager approach, management of market and investment risk factors (including ESG), research approach, performance record, investment risk approach and reporting, quality and timeliness of valuations, stress testing and liquidity arrangements. Operational due diligence of the investment manager would assess organisational structure, governance, execution processes, compliance risk and monitoring, valuation policies, IT security, business continuity management, service provider oversight, and derivatives exposure management. An RSE licensee would also consider the additional risks introduced by derivative exposure and the extent to which this is consistent with the RSE licensee's investment strategy and risk appetite. Operational due diligence results would form an integral part of the manager selection process.
63. Where an RSE licensee manages assets internally, the RSE licensee would ensure due diligence is conducted in accordance with a specifically documented process to ensure that appropriate systems, data, processes and personnel are in place to manage investments. This would be conducted by persons independent to those managing the investments. APRA expects either the Board or Board committee, where relevant, would approve internally managed investment strategies.
64. Specific agency risks arise where an RSE licensee manages assets internally. APRA expects an RSE licensee would have a performance assessment process which takes into consideration these risks. Performance attribution, assessment and reporting would be conducted by a business unit or division with a reporting line to an executive other than the Chief Investment Officer (or equivalent role) and include a process for addressing underperformance or risk outcomes outside approved parameters.
65. An RSE licensee would have the appropriate skills and resources available to undertake the internal management of investment portfolios, if it chooses to do so. The number of personnel, and their skills and experience, would be comparable to what would be expected of an external investment manager undertaking an equivalent activity. Further, the systems, data, operations and policies supporting internal investment management would be comparable to what would be expected of an external, highly-capable investment manager undertaking an equivalent activity.
66. Where an RSE licensee engages asset consultants or other advisors to support the due diligence process, an RSE licensee would ensure that the criteria used by consultants or advisors are consistent with the RSE licensee's appetite for whether an asset or

investment manager should be included, retained or terminated from a portfolio, and any potential conflicts of interest are appropriately identified and managed.

## Rebalancing

67. Rebalancing is an important mechanism for maintaining asset allocation within determined ranges over a reasonable timeframe. An RSE licensee may offer an internally developed investment option for the purposes of managing asset allocation, using either a strategic or dynamic asset allocation approach.
68. An RSE licensee would demonstrate how their approach to rebalancing considers:
- a) the timing of rebalancing through a combination of periodic rebalancing and established rebalancing triggers;
  - b) the use of derivatives to rebalance;
  - c) costs that may be incurred under normal and stressed operating conditions;
  - d) reporting to the Board and Board committee, where relevant; and
  - e) how significant deviations in asset allocations are disclosed.
69. Where an RSE licensee uses an investment option as a liquidity provider, an RSE licensee would be able to demonstrate and clearly document the appropriateness of this purpose with reference to liquidity impacts, member equity and how these are considered through stress testing. An RSE licensee would also ensure liquidity provider arrangements are subject to periodic review and regular oversight by the Board or Board committee, where relevant.

## Transitioning investments

70. An RSE licensee would demonstrate how it manages the transition of investments in the event of a change of investment strategy, investment manager or successor fund transfer to another RSE. For the transition of large or complex investments, an RSE licensee would establish a transition plan that specifies the objectives of the transition, timeframes to complete and measures to monitor the success of the transition.

## Monitoring investments

25. An RSE licensee must determine appropriate measures, for the purposes of monitoring performance on an ongoing basis, in respect of each MySuper product, each investment option and each investment within an investment option. These measures must include appropriate performance benchmarks and a methodology for setting performance benchmarks. These measures, other than performance benchmarks for each investment within an investment option, must be approved by the Board.
26. An RSE licensee must ensure that the performance of each investment option and each MySuper product 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 25.
27. An RSE licensee must ensure that persons undertaking the assessment of performance, by applying and assessing the measures required in paragraph 25 are operationally independent from persons who are responsible for making the investment.

### Monitoring investment performance

71. While APRA expects performance and risk outcomes of investment options would be reported to the Board on at least a quarterly basis, it is open to an RSE licensee to adopt a different approach to reporting on individual underlying investments where it provides the Board and/or Board committee with sufficient visibility over drivers of performance outcomes and the opportunity to better understand particular assets or asset classes.
72. APRA expects an RSE licensee would be able to demonstrate how the approach for reporting to the Board and/or Board committee supports information about performance that is timely, relevant and enables effective challenge and understanding of the drivers of performance through attribution analysis. At a minimum, such monitoring would include information with respect to the legislated annual performance assessment and APRA heatmaps.
73. An RSE licensee would be able to demonstrate how they ensure oversight of the underperformance of assets or externally managed investment options, including by using 'watch-lists' or taking remedial action, such as restricting flows or closing options.



## Reviewing the investment strategy

28. For each investment strategy, an RSE licensee must have a review policy that is approved by the Board and that, at a minimum, requires each investment strategy to be reviewed against its investment objectives on at least an annual basis. The policy must also include:
- a) the triggers that will cause an interim review of the investment strategy in addition to the annual review;
  - b) the processes for reporting the results of each review to the Board; and
  - c) the criteria that will determine whether the investment strategy must be changed.
29. On receipt of the results of a review of an investment strategy undertaken in accordance with the review policy, the Board must ensure that any decision to amend the investment strategy is supported by sufficient justification and analysis.
74. An RSE licensee would document the types of events that might trigger an interim review of the investment strategy, including, but not limited to, significant events in the economic environment, structural changes in the membership profile resulting from merger activity, material outflows or reduction in anticipated inflows.
75. An RSE licensee would document how, and for how long, it will monitor the impacts of specific amendments to the investment strategy to address underperformance to assess whether the desired outcome has been achieved.

# Stress testing

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## The stress testing program

30. An RSE licensee must have a comprehensive investment stress testing program that is approved by the Board and is integrated into an RSE licensee's investment governance framework.
31. An RSE licensee must, at a minimum, determine appropriate adverse stress scenarios for the investment strategy of each option. These adverse stress scenarios must cover a range of factors that can create extraordinary losses or make the control of risk within accepted tolerance level in the investment strategy difficult.
32. An RSE licensee's comprehensive investment stress testing program must provide for:
  - a) investment stress testing performed prior to the implementation of the investment strategy;
  - b) investment stress testing based on scenarios determined in paragraph 31 to confirm that each investment strategy, including the targets and ranges set under paragraph 20(c) and paragraph 21(a) remain appropriate on at least an annual basis; and
  - c) investment stress testing based on scenarios determined in paragraph 31, and other parameters deemed appropriate by the RSE licensee, to assess the performance of each investment option based on the actual asset allocation on at least an annual basis.
33. The comprehensive investment stress testing program must, at a minimum include:
  - (a) clearly articulated stress testing objectives, methodology, assumptions, frequency (at least annually), and risk factors, including the rationale for the severity of the adverse stress scenarios as required in paragraph 31;
  - (b) 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;
  - (c) investment stress testing output or metrics that demonstrate the performance of each investment option under the stress scenarios required in paragraph 31;



- a) **member generated events:** changes in switching behaviour, redemptions and contributions;
- b) **investment manager events:** suspension of redemptions;
- c) **investment/asset specific events:** capital drawdowns, settlements of currency hedging instruments;
- d) **market driven events:** significant downturn in equity markets;
- e) **policy driven events:** a change in Government policy, for example, related to access to accrued member assets; and
- f) **RSE specific events:** large scale redundancies, economic downturns.

80. The use of climate risk scenarios can help to inform risk identification over various timeframes. In this context, APRA expects an RSE licensee would:

- a) consider climate scenario analysis and stress testing to understand exposure to material climate risks and the potential impact of the investment strategy on market-wide risks over both the shorter- and longer-term. Such risk stress would be undertaken in a manner that is proportionate to the size and complexity of the investments; and
- b) consider scenarios that assess both physical and transition risks. APRA expects an RSE licensee would conduct quantitative analysis where data or proxies are available, supported by qualitative inputs as relevant.<sup>1</sup>

81. An RSE licensee would review its stress testing methodology at least annually to ensure assumptions remain appropriate. This review would account for changes in market conditions, investment strategy and circumstances that may affect the liquidity requirements of specific investment options.

82. An RSE licensee may consider it appropriate to use stress testing conducted by an external investment manager or external service provider as an additional source of expertise where it is demonstrably consistent with the RSE licensee's overall stress testing program.

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<sup>1</sup> CPG 229 provides further guidance on the short and long-term scenarios that an RSE licensee would consider.

## Stress testing results

34. An RSE licensee must ensure that the results of the comprehensive investment stress testing program are:

- a) reviewed periodically by the Board, relevant Board committees, and senior management; and
- b) reflected in the RSE licensee's investment governance framework.

83. Clear and meaningful reporting to the Board and Board committees enables the Board to understand and challenge the insights from stress testing and the potential actions relating to investment decisions that might be taken to respond to the results.

84. APRA expects an RSE licensee would demonstrate how its stress testing program informs, at a minimum, its business planning process and investment strategy, including risk tolerances and liquidity management plan. APRA expects stress testing results would promote challenge from, and provide insights to, the Board about the potential impacts of different scenarios on outcomes for beneficiaries.

## Stress testing methodology

35. The Board must document the methodology for stress scenario selection and how the results of the comprehensive stress testing program have been used in decision-making.

85. The Board would demonstrate how it provides input and challenge in the development and consideration of the plausible, but severe, scenarios most relevant to the RSE's investments.

86. An RSE licensee would demonstrate how the design of the comprehensive stress-testing program is appropriate to the RSEs, products and investment options offered by the RSE licensee. This includes, but is not limited to:

- a) how stress-testing by undertaking scenario analysis and stress-testing in the form of sensitivity analysis is appropriate given the nature of the investment option;
- b) how historical events and hypothetical events are to be used; and
- c) how assumptions are used to establish parameters in stress-testing.

87. An RSE licensee would ensure that reporting to the Board would explain the basis for choosing scenarios, the assumptions used, including any key limitations, the outcomes of the stress testing and potential actions that are to be considered, including any rebalancing or risk mitigation activities.

# Liquidity management

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## Liquidity management plan

36. An RSE licensee must, at a minimum, have a liquidity management plan, approved by the Board, for each RSE within its business operations that:
- a) covers each investment option in the RSE;
  - b) outlines the procedures determined by the RSE licensee for measuring and managing liquidity on an ongoing basis;
  - c) includes consideration of how the liquidity of investment options in an RSE can be managed in a range of stress scenarios;
  - d) identifies the circumstances the RSE licensee considers to be a significantly adverse liquidity outcome that requires action (liquidity event);
  - e) outlines what action the RSE licensee will take when a liquidity event occurs;
  - f) outlines the roles and responsibilities of persons involved in the management and oversight of liquidity risk, including the role of the Board, relevant Board committees and senior management; and
  - g) outlines information, including key metrics, that must be reported to the Board, relevant Board committees and senior management, to ensure adequate oversight of liquidity risk.

88. Liquidity management ensures that an RSE licensee can meet its liquidity requirements, including ensuring beneficiaries can redeem investments, when required, in a range of market conditions. It is important that an RSE licensee has a clear understanding of the liquidity demands on the RSE, and each investment option, and how these demands might affect asset values and the RSE licensee's ability to meet portability and payment obligations.

89. APRA expects an RSE licensee would demonstrate an understanding of the key sources of liquidity, the certainty as to its availability and reliability and the potential for these sources to deteriorate, supported by stress testing.

90. APRA expects that an RSE licensee would demonstrate adequate liquidity management practices commensurate with the nature, risk and complexity of investments and business operations. An RSE licensee would demonstrate how their liquidity risk tolerances are informed by characteristics of the RSE and its investment options through consideration of benefit design, member demographics, the range of investment options offered and the level of transactional activity.

91. An RSE licensee would develop and monitor:















