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General Manager
Policy
Australian Prudential Regulation Authority

By email: [REDACTED]

17 March 2023

Subject: Consultation on SPG 530 (Investment Governance in Superannuation)

Dear [REDACTED],

Mercer welcomes the opportunity to provide comments on APRA's draft Superannuation Practice Guide SPG 530 released in November 2022.

Introduction

Mercer acknowledges the importance of the superannuation system in supporting the wellbeing and dignity of the Australian community in retirement. We also acknowledge the critical role that investments, and specifically investment governance, plays in ensuring that appropriate member outcomes are delivered.

We welcome APRA's proposed updated guidance in SPG 530 and particularly the clarification on the role of Boards in investment governance. However, we have identified several issues that would benefit from additional guidance or further explanation from APRA in order to reduce potential ambiguity and ensure that the processes that are created by Trustees are in alignment with APRA's expectations.

Commentary and recommendations in relation to the content of SPG 530

Board's responsibility to access external expertise

As noted above, Mercer supports APRA's focus on clarifying and uplifting the role of the Board in investment governance. However, some guidelines in the draft SPG 530 create potential ambiguity about what APRA expects of Boards in relation to accessing their external experts, particularly when combined with the draft guidance on ensuring "an appropriate non-executive view of investment decisions".

Table 1 summarises the relevant clauses of the updated draft Practice Guide.

Table 1. Draft SPG 530 clauses in respect of access to external expertise

SPG 530 Relevant Clauses	
Paragraph 3c	<i>“The Board would be able to demonstrate that it has <u>access to external experts to support the Board</u>”.</i>
Paragraph 4	<i>“When considering the appropriate level of Board oversight of investments, APRA expects the Board would be able to demonstrate how it <u>effectively</u> ensures an appropriate <u>non-executive view of investment decisions</u>.”</i>
Paragraph 99:	<i>“It is important that the Board has <u>adequate expertise and resources available to it to support a robust valuations framework</u>.”</i>

Our specific commentary on these clauses is as follows:

- **Paragraphs 3c and 99:**

As a general principle Boards can, and do, seek their own advice in addition to what is provided by the superannuation fund’s management team on various issues, including investments, if they consider this to be appropriate or necessary. This has not been a controversial point in the past. However escalating this right of the Board to “access .. external experts *to support the Board*” to one of four core expectations in relation to Boards’ responsibilities, implies a level of significance that we suggest could benefit from additional APRA commentary.

In contextualising these points, we believe it would be helpful if APRA provided clarity regarding:

- Is APRA expecting more pro-active/frequent use of external experts by Boards as a way of getting comfort about management’s recommendations and decisions?
- How APRA expects a Board to “demonstrate” that it has access to external experts?
- Where management has sought external advice as part of developing their recommendations for the Board (or making their investment decisions) and provided this advice to the Board - would this constitute the Board “having access to external experts” or would APRA expect the Board to seek “its own” separate advice?

To have greater certainty on what APRA expects from a Board, it would be helpful if APRA provides more information on how it would expect paragraph 3(c) of draft SPG 530 to be applied by Boards in practice and how this relates to the guidance on paragraph 99.

- **Paragraph 4**

In relation to paragraph 4, we note that Boards (and related Board Committees) provide oversight of investment decisions and that most superannuation fund Boards are made up of non-executive directors who are not involved in the day-to-day management of the fund. In this context, it is not immediately clear what additional steps APRA expects a Board to take to demonstrate effective “non-executive view of investment decisions”. For example:

- Does APRA expect this to cover cases where investment expertise on the Board (or Committee) is not sufficient? If yes, who is responsible for making this assessment?
- Does APRA expect Boards to utilise external experts more frequently?
- Does APRA expect tighter delegations with more Board (or Committee) oversight?

We therefore recommend that SPG 530 provides further explanation or guidance on how APRA expects paragraph 4 to operate in practice.

ESG Risk Factors and Climate Scenarios

Mercer is supportive of the additional guidance in SPG 530 in the expectation to incorporate ESG risks factors and climate scenarios in investment decision making. This aligns well with Mercer's own investment beliefs, approach and philosophy on sustainable investments. We do want to raise however that the integration and consideration of ESG factors and climate change does vary across asset classes:

- For listed equities:
ESG data is now available through third party ESG data/service providers. Investment analysis, and oversight into ESG factors and climate change and how it impacts the listed portfolio is becoming more manageable. Where it becomes challenging is for unlisted assets.
- For unlisted assets:
There is an inherent lack of ESG data due to the unique and opaque nature of these assets and how they operate. This lack of useful or meaningful data may mean Trustees need to rely on qualitative assessments to satisfy APRA's requirements.

We recommend that APRA's guidance acknowledges that the integration and consideration of ESG factors including climate change varies across asset classes. For unlisted assets, there is limited/varied level of ESG data available to trustees and that APRA takes this into account when assessing trustee's compliance with SPS530 and trustee's approach to ESG guidelines in SPG530. For instance, this could take the form of extra commentary in respect of Paragraph 47, 48, 49 and 82 (climate scenarios) of SPG530.

Differentiation in fund structure

SPS 530 and the draft SPG 530 do not differentiate between different fund structures such as platforms with large number of investment options. It is our view that this does not support a level playing field as such funds (e.g. wrap products) will find it more challenging (and costly) meeting the expected uplift in reporting and analysis expected under the new guidelines. For example, accurate aggregation of attribution analysis is likely to be difficult in cases where investment portfolios are externally managed by a range of third party managers.

We recommend SPG530 articulates a level of flexibility in terms of the level of detail to be provided to Boards, subject to the Boards being satisfied that the information provided has sufficient detail to enable informed decisions about the investment options.

Commentary on the timing SPS530 and SPG 530

We note APRA's stated expectation that RSE licensee will have met the requirements of updated SPS 530 from its start date of 1 January 2023, taking into account the draft SPG 530. While we agree that Trustees have had time to process the updates to SPS 530, we expect that this is less

likely with regard to the current draft version of SPG 530. Within this we note APRA's intention to engage with Trustees in the second half of 2023.

Our expectation is that Trustees may have struggled to develop and implement processes which are commensurate with the draft SPG 530 as this would have required assumptions to be made regarding the draft document (which is subject to change). This applies both prior to its release (to comply with the 1 January 2023 timeline) and during the consultation period (to effect appropriate processes) and is largely the consequence of SPG 530 being released part way through Quarter 4 of 2023.

In light of this condensed timeline, we recommend APRA provides more detailed guidance on what APRA expects of Trustees in 2023. For example, this could include guidance that APRA expects Trustees to be fully compliant with SPS530 through 2023 with an appropriate approach to SPG530 expected to be in place in Calendar Year 2024, allowing 12 months from the date the final guidance is released.

Commentary on Integrated Approach of SPG 530

Through its consultation process we note that APRA has sought feedback on its approach of releasing an integrated draft SPG 530. We are strongly supportive of this initiative and understand that it has assisted trustees in meeting the relevant requirements with greater clarity and understanding.

We recommend APRA to continue to pursue this integrated approach for other key prudential practice guides.

Concluding remarks

Mercer welcomes the recent enhancements to SPS 530 and the proposed enhancements to SPG 530 and we look forward to the finalisation of SPG 530 to guide RSE licensees in their compliance with SPS 530. We nevertheless encourage APRA to be cognisant of the inherent complexity of investment governance, the diversity of fund structures and the importance of providing Trustees with clarity of APRA's expectations.

In summary, we suggest that SPS530 and SPG530 should allow reasonable flexibility for Boards to manage investments efficiently, effectively and consistent with the best financial interests of fund members. We would be happy to discuss any of the above comments with you and your team as you consider these matters.

Yours sincerely,

A black rectangular redaction box covering the signature of Dr David Knox.

Dr David Knox
Senior Partner