

23 March 2023

General Manager, Policy

By email: [REDACTED]

Dear Sir/Madam

## DRAFT PRUDENTIAL PRACTICE GUIDE SPG 530 INVESTMENT GOVERNANCE (SPG 530)

On behalf of the Australian Council of Superannuation Investors (ACSI), thank you for the opportunity to make a submission to the consultation on APRA's draft Prudential Practice Guide SPG530 Investment Governance (SPG530).

### About ACSI

Established in 2001, ACSI exists to provide a strong voice on financially material environmental, social and governance (ESG) issues. Our members include 26 Australian and international asset owners and institutional investors with over \$1trillion in funds under management.

Through research, engagement, advocacy and voting recommendations, ACSI supports members in exercising active ownership to strengthen investment outcomes. Active ownership allows institutional investors to protect and enhance the long-term value of retirement savings entrusted to them to manage.

### Overview

SPG 530 provides guidance to trustees in the formulation, implementation, maintenance and oversight of the investment strategy. Trustees and other stakeholders have consistently recognised that some aspects of the current SPG530 fail to reflect contemporary investment practice, in particular the importance of identifying and managing ESG risks, including through appropriate stewardship practices. While we welcome the update to SPG 530, the wording in the draft does not yet meet APRA's intended aim of greater clarity, and we offer recommendations for improvement.

### Updating Guidance to reflect market practice

ACSI welcomes the update, as the existing SPG530 confuses ethical investing (or other strategies that pursue non-financial outcomes as the 'end objective') with the integration of ESG factors by mainstream investors as part of prudent risk management<sup>1</sup>. We support APRA's acknowledgement in the draft SPG530 that material ESG risks should be incorporated into investment practices.

ACSI also supports the recognition that ESG risks and opportunities extend beyond climate risk, and investors regularly consider other financially material ESG factors such as corporate governance, human rights (including modern slavery) and diversity and inclusion. ACSI also notes that ESG issues are referenced throughout many sections of the draft SPG530, which reflects the widespread and integrated nature of ESG issues.

The financial materiality of ESG issues is now widely recognised and well supported by many studies<sup>2</sup>. The focus on the financial materiality of ESG factors in Paragraph 47 of the draft SPG530 is also consistent with focus by the International Sustainability Standards Board (ISSB) on materiality. We recommend that APRA continue to monitor developments in sustainability risk reporting to support alignment with the ISSB standards.

<sup>1</sup> This can include pursuit of sustainability (at the asset or portfolio/systemic level) as a means of enhancing the financial performance of an investor's portfolio. See, Freshfields (2021), *A Legal Framework for Impact*, at 13 (distinguishing between (1) *instrumental* investing, which includes pursuing sustainability to protect or enhance the performance of a portfolio, including "to support the sustainability of economic, environmental and social systems on which financial value depends", and (2) *ultimate ends* investing, where achieving the relevant sustainability impact goal is distinct from and pursued alongside financial return goals).

<sup>2</sup> 'Financial Materiality and ESG' at <https://acsi.org.au/research-reports/financial-materiality-and-esg/>

Nonetheless, we recommend that the draft SPG530 would benefit from review to ensure the references to ESG and/or ESG Factors are used consistently throughout the document. Where it makes sense, references to ESG should be harmonized to use the defined term 'ESG Factors'.

For example, paragraph 60 is confusing in its references to 'ESG opportunities'. While it is clear there are both risk and opportunities associated with ESG factors, in the context of due diligence and investment assessment, both risks and opportunities should be taken into account. We recommend that the paragraph be reframed, in particular to remove the references to 'potential expected returns' and instead consider language that supports RSE licensees to 'undertake appropriate investment assessment, that includes material ESG Factors, and be able to demonstrate how the opportunity aligns with investment strategy and objectives'.

### Giving effect to the investment strategy

Paragraphs 73 and 74 of the draft Practice Guide appear to relate to 'impact investing' or similar, rather than ESG integration. Impact investing<sup>3</sup> is often defined as a strategy that aims to deliver a positive environmental or social outcome alongside investment returns, whereas the practice of ESG integration involves incorporating ESG risks and opportunities into an investment strategy and decisions, with the ultimate objective being financial returns. We recommend that this distinction be clarified, in particular in this section of the draft SPG530. In particular, it appears that paragraphs 73 and 74 are providing guidance on impact investing. If this is the case, we recommend that the location of those paragraphs be moved to a more appropriate section of the document, for example to 'Formulating the Investment Strategy'. In addition, we recommend that the term "ESG" be removed from the header, and the section be titled 'Additional impacts' or 'Impact Investing' to avoid confusion between impact investing (or similar) and ESG integration.

### Stewardship

Stewardship is widely recognised as a core part of the fiduciary duty to maximise overall long-term value.<sup>4</sup> Stewardship includes the responsibility of asset owners to exercise their ownership rights to protect and enhance long-term investment value for their beneficiaries. Asset owners achieve this by promoting sustainable value creation in the companies in which they invest.

Recognition of the role of investor stewardship is well established globally. Research has found that there is widespread acknowledgement of the role of stewardship in addressing systemic issues and changing corporate behaviour, all to protect and enhance investment outcomes.<sup>5</sup> The prevalence of investor stewardship codes and/or regulations across markets reflects its acceptance as an important aspect of risk management, and part of fiduciary duty. The UK Stewardship Code is a good example, underpinned by regulation. The UK Stewardship Code also includes a principle that acknowledges ESG factors as an important part of good stewardship. Principle 7 of the UK Stewardship Code asks signatories to 'systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfill their responsibilities.'<sup>6</sup> This reflects the importance of trustees including stewardship and consideration of material ESG issues into their investment strategies and decisions.

ACSI supports the inclusion of references to stewardship in the draft SPG530. Effective stewardship encourages long-term value creation and good governance, and we welcome recognition that effective stewardship generates investment value. However, the updated SPG530 would benefit from a clearer definition of stewardship. The wording in paragraph 75 of draft SPG530 is confusing, as it appears to suggest that the voting or investment power is synonymous with stewardship activity. While use of voting power is one aspect, stewardship activity is broader than just voting. The updated definition should include references to various forms of stewardship activity, including those that extend beyond listed markets. This would also include engagement meetings with board and management of investee companies, other activities such as public statements or shareholder resolutions and policy advocacy (as well as voting). Importantly, each investor should be able to choose the stewardship approach that is appropriate for its investment strategy and investment objective, with the overarching focus on how stewardship activity supports the best financial interests of beneficiaries.

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<sup>3</sup> RIAA defines Impact investing as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return." <https://responsibleinvestment.org/what-is-ri/ri-explained/>

<sup>4</sup> Principles for Responsible Investment, 2021, Stewardship, <https://www.unpri.org/an-introduction-to-responsible-investment/an-introduction-to-responsible-investment-stewardship/7228.article>

<sup>5</sup> Responsible Investment Association Australasia (RIAA), 2022, Unpacking Stewardship in Australasia in 2022, <https://responsibleinvestment.org/stewardship-study/>

<sup>6</sup> [https://www.frc.org.uk/getattachment/5a9e591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code\\_Dec-19-Final-Corrected.pdf](https://www.frc.org.uk/getattachment/5a9e591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf)

In addition, the inclusion of the paragraphs on stewardship under the header 'Additional ESG Impacts' is confusing. As set out above, investor stewardship is widely recognised as part of an investors' fiduciary duty and a key risk management tool. Investor stewardship is commonly accepted to form part of fiduciary duty, to manage risk and realise opportunity, which includes a consideration of ESG factors. Therefore, the location of the paragraph on stewardship with 'Additional ESG Impacts' (relating to impact investing or similar) has the potential to confuse investment stewardship and impact investing. Accordingly, we recommend the location of references to stewardship within SPG530 be reconsidered. We recommend that stewardship have its own specific section sub-titled 'Stewardship'.

Finally, sections (a) to (d) of paragraph 75 may cause confusion given the level of detail and prescription proposed.

It is unclear how a Trustee would meet APRA's expectations in respect of the factors listed in (a) to (d), and why they are necessary, given the degree to which those expectations could be perceived to overlap with the 'best financial interests' duty and existing disclosure provisions. Many funds have existing processes to demonstrate how their stewardship activity is consistent with the 'best financial interests' duty.

It is appropriate that funds' stewardship activity be fit for purpose, and that funds are able to demonstrate that their governance over their stewardship activity is focused on the requirements of the best financial interests duty, and that there are processes to support and demonstrate this focus. APRA's emphasis should be on this accountability, rather than seeking to attribute specific outcomes to particular stewardship activities, (noting of course that overall, stewardship activity should seek to be effective and have clear aims). Paragraph 75(a) is open to unintended consequences given that it refers only to value creation, rather than also including the role stewardship has in preventing value destruction. We recommend that a more efficient approach would be to reinforce the fact that stewardship activities must occur within, and be guided by, the duty to act within the best financial interests of beneficiaries, along with the existing strict requirements to demonstrate that the fund meets this standard.

If APRA is seeking to encourage funds to disclose their stewardship activity, we recommend that APRA clarify the additional disclosure it is seeking. It would also be useful that any additional guidance in respect of disclosure is aligned with existing industry codes,<sup>7</sup> in the interests of efficiency. Our view is that a Stewardship Code can provide useful guidance to support communication between investors and beneficiaries, as well as accurately communicate some of the complexities in respect of stewardship activities such as engagement and voting practices.

### Other – Investment Operating Model

The draft SPG530 appears to suggest that when considering internalization, external investment managers are the appropriate benchmark (see for example paragraphs 12 and 64). It is unclear why external managers are considered to be the appropriate benchmark, and we recommend that APRA reframe these references to instead refer to demonstrating the internalization process is fit for purpose. In this sense the proposed language in paragraphs 10 and/or 11 is more appropriate.

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

Yours faithfully



Louise Davidson AM  
Chief Executive Officer  
Australian Council of Superannuation Investors

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<sup>7</sup> For example, the Australian Asset Owners Stewardship Code