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General Manager, Policy
Australian Prudential Regulation Authority
superannuation.policy@apra.gov.au

Re: Consultation on draft prudential practice guide on investment governance (SPG530)

AustralianSuper welcomes the opportunity to provide a submission in response to the draft Prudential Practice Guide on Investment Governance (SPG530) and we thank APRA for their engagement in relation to this issue.

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. Over 3 million Australians are members of AustralianSuper with over $274bn in member assets under management. We are the custodians of the retirement savings for one in 8 working Australians. It is essential that our structures and processes provide investment governance and valuations of the highest standard to ensure our members can achieve their best financial position in retirement.

1. General comments

AustralianSuper is supportive of the enhancements being made in relation to investment governance and valuations. We believe it is important that these standards and processes reflect the fact that many superannuation funds are increasingly large and complex entities.

We have established a comprehensive and effectively delegated governance model with appropriate oversight, checks and balances; however, we note that some parts of the draft guidance could currently be interpreted as requiring some aspects of our processes to be rolled back. This is addressed in our comments below.

2. Investment Governance Framework

We agree with, and support the intent of, paragraphs 1-5 setting out the responsibilities of the Board. We note the guidance to ensure that there are clearly documented delegations that consider roles and decision-making responsibilities, including between those implementing investment decisions and those reviewing performance. We have established segregated and well-resourced teams within the Fund with clear responsibilities across performance, valuations, risk, cost, and other key aspects of investment governance.

We would further observe, in relation to these matters, that:

- Boards should demonstrate not just delegations, but adequate processes and resourcing to deliver on the Board's requirements; and
- Investment decision makers also require access to in-depth information and analysis to make investment decisions to meet investment objectives. This should include access to the information and reporting produced by the functionally segregated teams. In addition, our view of best practice is that investment decision makers should also include information and reporting produced by the investment teams, where such information and analysis can contribute to the effective implementation of strategy to achieve investment objectives.

We agree that a licensee’s governance arrangements should appropriately consider member equity risk. We note there are already provisions under superannuation law for the gating of member redemptions in extreme circumstances, and agree in particular with the intent of subsection three on the need for single sector investment options where liquidity impacts may be greater. We suggest widening this to require that licensees consider monitoring arrangements for all options, and in particular single sector investment options.

We agree that a licensee’s management of member equity risk should include and be informed by appropriate estimation, analysis, and importantly process, to ensure that the trade-offs involved in managing member equity risk are appropriate. However, the monitoring and quantification of the provision set out in subsection two of paragraph nine would be highly complex, costly, and subject to significant uncertainty given the complexity of Fund structures, member allocations across Investment Options, and the need to make assumptions on counterfactuals like valuations. It is not obvious that extensive modelling and estimation of these impacts would be in members’ best financial interests.

Paragraph 21 requires that a licensee must review ‘*all relevant policies and procedures’* as part of its triennial review of the investment governance framework. We note that in practice many licensees, including AustralianSuper, incorporate many policies and executive-approved procedures by reference via their investment governance framework document. Further, given the wide range of coverage for this documentation, a process of rolling reviews is in place. This process enables more important documentation to be prioritised and reviewed more frequently and smooths the burden of reviewing documentation on management and the Board. We suggest it could be noted that a licensee may make use of rolling reviews as part of its process for ensuring that the investment governance framework is appropriate.

Paragraph 24 requires that licensees demonstrate how the investment outcomes sought for each investment option support the outcomes sought for different member cohorts. This should be clarified to state that such a demonstration is only required where a licensee seeks to align the investment strategy (and therefore investment outcomes) of each investment options to particular member cohorts.

We support the overall guidance on investment stress testing and believe that such testing is an integral component of both investment strategy development and risk management. However, we note that some of the guidance on the Board’s role (in particular around the development and consideration of scenarios most relevant to the RSE’s investments in paragraph 87 and elsewhere) could lead to unintended consequences. In particular, it could encourage the use of static, historical scenarios with extreme downsides that provide little new information to Boards, given the potential burden of reviewing and updating stress scenarios.

Our process embeds stress testing deeply into the development, implementation, and monitoring of our investment strategy. This means that we frequently update our stress scenarios, informed by our strategy, markets, and economic conditions, amongst others, and frequently provide relevant information to the Board on the development of scenarios at the same time as we provide the results of stress testing. We believe this process is appropriate given our investment strategy and the delegations in place to the Board Investment Committee, where stress test assumptions are reviewed and challenged in depth. We suggest that guidance should note that the information provided to the Board on stress testing be scaled by the Board’s scope of decision making and delegations.

Paragraph 84 provides for the use of external service providers for conducting stress testing. Given the importance of stress testing to investment strategy and risk management, we are of the view that external service providers should only be used as an additional source of stress testing information, and not as a licensee’s only source.

The SPS at paragraph 32 states that a licensee's stress testing program must provide for testing to occur "*on at least an annual basis*". But the draft SPG at paragraph 79 states that "*APRA expects this* (the frequency with which stress-testing would be conducted*) would be undertaken at least quarterly*". This is a clear extension of the expectations set out under SPS 530, and one which has the potential to cause confusion on expectations. AustralianSuper supports the guidance set out on the need to undertake ad-hoc stress testing, including via the use of market measures and triggers, and believes this should guide the undertaking of stress testing more frequently than annually.

3. Valuations and delegations

AustralianSuper welcomes the focus on valuation processes. It is critical that all superannuation funds have appropriate procedures in place to ensure that members best financial interests are advanced and protected.

Our processes aim to establish the fair value of investment assets in accordance with accounting principles and applicable regulatory guidance. In doing so we seek to incorporate the principles of:

- **Equity** - Achieve equity across members as they enter, leave, remain constant or transact within the Fund;
- **Independence** - Ensure independence between the persons responsible for investment decision making and those responsible for the valuation of Investment Assets;
- **Risk** - Manage the risk of materially misstated or outdated valuations of Investment Assets, including during periods of stressed markets;
- **Materiality** (and frequency) – Application of our processes will consider materiality of the investment in terms of total assets and investment option;
- **Objectivity** – Source of valuation from the most objective, market based through to the subjective unobservable.

Our valuation policy and governance is approved by the board. Additionally, our governance framework includes a dedicated and stand-alone Valuation Team and Valuation Committee in place to ensure there is proper oversight of the valuation of investments.

We do not believe that investment monitoring, liquidity risk, and the valuation governance framework and oversight should automatically require the establishment of separate board committees for each area. Funds differ in size, complexity, and investment approach; consequently, each fund should be empowered to determine the governance and level of delegated responsibilities, that meets their needs while acknowledging that the Board maintains ultimate responsibility.

The SPG should require the description and documentation of delegations and make it clear out that super funds can have appropriate governance processes that do not require a stand-alone Board valuation committee.

4. Investment Strategy

Paragraph 60 speaks to the need to undertake appropriate investment analysis as part of due diligence, including the need to assess the investment impact of ESG issues. We agree with this requirement, but believe the current wording is ambiguous, and suggest an amended version which includes some minor changes to the current drafting:

Current wording

60. APRA expects an RSE licensee would undertake appropriate analysis, including seeking evidence of the potential expected returns to assess ESG investment opportunities, demonstrating how the opportunity aligns with the overall investment strategy and satisfies the investment objectives.

Suggested wording

60. APRA expects an RSE licensee would undertake an appropriate investment assessment which includes understanding the investment impact of ESG factors. This assessment would ensure the investment opportunity aligns with the overall investment strategy and satisfies the investment objectives.

We agree with the point raised in paragraphs 73 and 74 that licensees should be able to pursue environmental and social objectives where such objectives are not inconsistent with the delivery of investment outcomes; however, the wording in these paragraphs is ambiguous. The description of such objectives as '*non-financial'* is problematic and contrary to the intention of this paragraph, and potentially contrary to the Trustees' overall duty to manage investments in the best financial interests of members.

We suggest changing the heading from "*Additional ESG impacts*" to "*Monitoring ESG Factors*".

We suggest the following wording for Paragraphs 73 and 74, which may be more easily interpreted together as a single paragraph:

73. An RSE licensee may pursue additional objectives from investments, such as environmental or social objectives, where it can demonstrate that pursuing such additional objectives is consistent with the delivery of investment outcomes that satisfy investment objectives. APRA expects an RSE licensee to demonstrate how it monitors the environmental or social objectives, using recognised industry criteria where appropriate.

We welcome the intent of paragraph 75, which we interpret as requiring that licensees demonstrate how their stewardship activities are aligned with, and contribute to, the meeting of investment objectives. However, there is some ambiguity in the wording of paragraph 75, including its narrow definition of stewardship as voting, and where it speaks to financial returns as opposed to the meeting of investment objectives, which is used elsewhere.

We suggest the following wording for Paragraph 75

75. An RSE licensee should consider how it uses its voting or other stewardship influence to contribute to the delivery of investment objectives. Where an RSE licensee engages in stewardship activities as part of its prudent management of investments, APRA expects an RSE licensee would be able to demonstrate and publicly disclose how such stewardship activities:

A. contribute to the delivery of investment objectives;

B. (No change)

C. (No change)

D. (Remove, captured in Paragraph 75)

5. Conclusion

Regulatory structures and processes that provide investment governance and valuations of the highest standard are essential to ensure all members achieve their best financial position in retirement. AustralianSuper welcomes and supports the enhancements being made in relation to superannuation investment governance and valuations.

If you have any questions in relation to this submission or would like to arrange a discussion, please contact James Bennett, Policy & Government Relations Advisor, jbennett@australiansuper.com

Yours sincerely

C.N.Cramond

Mark Comer & Chris Cramond
Joint Acting Chief Strategy & Corporate Affairs Officer