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Sent to: [REDACTED]

General Manager, Policy
Australian Prudential Regulation Authority
Level 12, 1 Martin Place
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Draft SPG530 Consultation

Thank you for the opportunity to provide feedback on JANA's views regarding the draft changes to Prudential Practice Guide SPG530 Investment Governance (SPG530). As Australia's largest asset consultant, we work with multiple superannuation entities on each area covered in SPG530 and believe we are well placed to respond to the consultation.

JANA is overall supportive of APRA's draft updates to SPG530. We believe there are areas where minor amendments would be beneficial and areas where clarification of certain aspects would also be beneficial. In our response we have first made some general comments on the draft updates to SPG530 and then commented on individual sections.

We would be delighted to discuss further any items covered in this consultation response.

Regards,

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About JANA Investment Advisers

JANA Investment Advisers was established in 1987 and is Australia's leading and largest investment advisory and research firm. For 35 years, we have provided considered and responsible advice to our clients, rooted in our depth of talent, global research, deep insight, and innovative thinking.

Today, we have grown to over 140 staff members, with \$1.3tn in funds under advice. A management-owned asset consultancy, JANA advises over 80 institutional clients across superannuation funds, universities, foundations, endowments, charitable trusts, insurers, corporate clients, long-service leave funds and family offices. JANA-advised clients have a history of outperforming both their internal benchmarks and peers.

At JANA, we believe that together with our clients, we can make a meaningful positive difference to the lives of millions of everyday people directly or indirectly impacted by the advice we provide. Therefore, we are strongly aligned to increase accountability for financial outcomes in superannuation and improve member outcomes.

General Comments on Draft SPG530

Principles-based nature of draft SPG530

JANA notes APRA's intention is for SPG530 to be principles-based rather than a prescriptive guide given the diversity in RSE structures across the industry. This means RSEs can implement the guidance in the way that best suits their entity and JANA supports this framework. However, JANA believes that the industry would benefit from the provision of information from APRA over time covering what APRA believes to be best practice in the different areas covered by SPG530. Guidance on best practice would be beneficial in the areas where APRA is looking for improvement from the industry and areas where the guidance in SPG530 has changed the most (e.g., valuation governance frameworks, stress testing and liquidity management). This information could be provided in c.12 months when APRA has engaged with RSEs regarding implementation of the changes to SPS530 and SPG530.

JANA is involved in several projects with our RSE clients where significant work is being undertaken to ensure standards around investment governance are elevated to market leading levels. We postulate that APRA releasing guidance in the future on different ways they have seen excellent investment governance will help drive a continued uplift in standards in investment governance across the industry.

Environmental, Social and Governance ("ESG") Considerations

JANA welcomes the focus on Sustainability in the guide. We note that the guide currently focuses on two elements of the Sustainability toolkit – Stewardship and ESG, with ESG defined with reference to CPG229, as *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*. However, we observe most of the text of SPG530 could be interpreted as focussing more on the ESG integration decisions around assets and companies.

While ESG integration and Stewardship are two important tools available to investors in achieving their investment and sustainability objectives, we consider that broader guidance around other Sustainability approaches would be welcomed. We note that RSEs are long term investors and many think in the 'universal ownership mindset', meaning they are broadly exposed to entire markets and are keenly interested in long term market outcomes, as well as those of assets, companies, and industries.

JANA believes that we need a sustainable environment and society to deliver long-term investment returns. Accordingly, we hold ourselves accountable for the impact we have on the environment and society. Considering the broader picture, we believe that a system-wide approach will deliver better investment and real-world outcomes over time. However, this necessitates taking a long term, universal ownership mindset.

We believe guidance from APRA around how RSEs are expected to calibrate a universal ownership mindset in the context of SPG530 would be welcomed.

We believe APRA's guidance on other sustainable investment approaches that are gaining traction amongst institutional investors (including positive thematic investing and impact investing) would be welcomed. This is especially so in the context of two competing dynamics:

1. The current Federal Government's public goal to establish a Sustainable Finance Strategy that would increase tailwinds behind many sustainable investment approaches.
2. A lack of clear consensus between institutional investors, Government, and regulators as to what is permissible in relation to the sustainable investment approaches under the current regulatory and legislative frameworks.

JANA supports the Federal Government's public goal to establish a Sustainable Finance Strategy which will help support the sustainability of investment returns over the long term. As currently drafted, SPG530 will potentially overemphasise short-term outcomes at the cost of investing for more sustainable long term returns and long term financial best interests.

Role and applicability of ESG integration

During recent consultations, several industry stakeholders noted that the current SPG530 implies that incorporating ESG factors is only appropriate for 'ethical' options or that incorporating ESG factors may be to the detriment of traditional return and risk objectives.

JANA notes that, like many market participants, APRA's views on the benefits of integrating ESG factors into the investment process have changed significantly since the 2013 version of SPG530 was released. We believe ESG integration applies to all investment options, not just 'ethical' options.

We consider that explicit guidance from APRA on the role of ESG integration across all options versus 'ethical' options only would be welcomed.

ESG Integration & Time Horizons

JANA interprets APRA's overall perspective on ESG integration in the draft SPG530 as being:

1. ESG-related opportunities and risks should be understood.
2. Quantifying ESG-related opportunities and risks should be undertaken to the extent that industry standards are available.
3. Investment decisions can be made based on ESG-related opportunities and risks to the extent that they promote financial returns for members.
4. ESG-based objectives can be pursued if they do not conflict with promoting financial returns for members.

We think it is important to highlight that many ESG considerations will play out over a multi-decade time horizon, and the financial benefits can often be challenging to quantify.

There are several issues for RSEs that we believe APRA will need to be cognisant of when engaging with RSEs in implementing SPG530.

- As ESG factors emerge, the capacity for investors to identify, manage and monitor will also be developing – i.e., it is improbable that any investor will have a complete framework immediately and the focus should be on ensuring appropriate frameworks are being developed.
- Even where ESG factors are well understood, quantifying the risk and return is not always possible or straightforward. Even where data exists, such as carbon data, there are differences of opinion on how best to use and interpret the data.
- Financial outcomes arising from the management of ESG risks will evolve over different time horizons. For example, the recent commodity price strength means that investment strategies underweight carbon will have likely underperformed, however, over the longer term, there is a strong argument to suggest that strategies that have an overweight exposure to carbon will be challenged as government policies are directed toward achieving net zero targets.

Comments on Individual Sections of Draft SPG530

Role of the Board

Paragraph 5: Board Committees

APRA has clarified expectations regarding the role of the Board in the updated Prudential Standard and draft SPG530. JANA notes that the degree of Board involvement required in investment matters is extensive. We also note that APRA's 30 April 2019 information paper 'review of APRA's 2013 superannuation prudential framework' notes that the establishment of a Board Investment Committee is one mechanism to ensure sufficient time is allocated to a complex area whilst allowing the wider Board to have the time to spend on other strategic matters. JANA agrees with the benefits of a Board Investment Committee (and other sub-committee structures, e.g. valuation committees, risk/audit committees etc). However, we believe clarification would be welcome on whether APRA is comfortable for Board delegated Committees to undertake the items APRA has outlined as the responsibility of the Board in SPG530 and the draft SPG530 or whether any decisions made by these Committees still require sign-off (as opposed to reporting of actions) from the overarching Board.

Investment Governance Framework

Paragraph 9i: Blackout Period

APRA notes its expectation that RSEs will enforce a blackout period for members transacting in an option around an expected asset revaluation period. JANA understands the rationale behind this inclusion, but we believe implementing this for all periods when unlisted assets are re-valued is not required. In normal market environments the impact of asset revaluations will be negligible, and any member equity benefits would be offset by frequent blackout periods that would restrict the ability of members to transact, potentially contributing to the erosion of confidence in the superannuation system. JANA believes a more balanced approach would be for blackout periods to apply to insiders with knowledge of asset revaluations rather than general members and for asset valuations to be spread throughout the calendar year. Alternative deterrents could also be considered such as identifying problematic member switching behaviour, educate the members and potentially limit switching if the problem continues.

In JANA's view, the industry would benefit from examples of considerations and expectations for consideration of blackout periods. This might include: (1) the quantum of illiquid or semi-liquid investments in a product subject to monthly/quarterly pricing; (2) the nature of the market

environment (normal or stressed) which may impact on the robustness of lagged valuations; and (3) in the context of 1 & 2, whether it is appropriate to allow members to transact, e.g. during periods of significant revaluations or if financial markets have deteriorated beyond a certain threshold.

Paragraph 11: Transitioning investment functions internally

APRA's guidance implies that the points stated are undertaken before any internalisation. JANA would expect that the operating model, including current and future internalised functions would be reassessed periodically (for example, triennially) to ensure it remains appropriate and that the Board would document this review. We advise APRA to consider a small amendment to paragraph 11 to emphasise the importance of the ongoing operating model review.

Paragraphs 20-21: Review of investment governance framework

APRA's guidance suggests the investment governance framework is comprehensively reviewed every three years. Including all the items outlined in paragraph 21 in the triennial review will be very expensive for an RSE and arguably inefficient given that many of the framework components will be reviewed on an interim basis. We suggest the guidance is modified to state that a holistic review is undertaken on a triennial basis subject to each framework component being reviewed within a three-year period.

Formulating the Investment Strategy

Paragraph 44: Diversification

The paragraph notes that "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." JANA notes that by definition single asset class options are undiversified and are unlikely to minimise risk as a stand-alone investment option. Even if focusing on diversification of securities within a single asset class, trade-offs may exist between reducing concentration risk and returns. What constitutes "appropriate diversification" may not always be well defined or empirically demonstrated. We believe the industry would appreciate clarity on how APRA intends for RSEs to provide guidance on how diversification can be demonstrated in this case.

Giving Effect to The Investment Strategy

Paragraph 75 – Stewardship

This paragraph notes that APRA expects an RSE licensee to publicly disclose its stewardship activities. JANA would welcome more clarity from APRA on what such disclosures should contain and/or references to stewardship standards that disclosures should comply with.

Stress Testing

Paragraph 82A: Climate scenario analysis

The paragraph notes that RSEs would "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." The second half of this sentence implies APRA expects the RSE will consider the impacts of its individual investment strategies on worldwide climate change. We assume APRA's intention is for RSEs to consider the impacts of the investment strategies **on exposure** to market-wide risks such as climate change risks rather than the impact of their strategies on climate change but we believe this paragraph should be clarified.

Liquidity Management

Paragraph 90: Premise behind liquidity management

The draft SPG530 articulates that liquidity management ensures that members can redeem investments, when required, in a range of market conditions. JANA believes liquidity management covers a broader range of liquidity requirements than member redemptions. Examples include funding commitments to unlisted asset programs and meeting currency hedging obligations and rebalancing overlay requirements as well as effective use of idle cash. Paragraph 90 rightly focuses on liquidity management during stressed periods for markets and the aforementioned additional liquidity requirements can often be more severe during times of stress and hence it is critical these are incorporated into the liquidity management plan. JANA recommends paragraph 90 is amended to acknowledge that liquidity management should cover all liquidity requirements rather than just member-driven trades.

Valuation Governance

Paragraphs 112-115: Interim valuations

JANA has reviewed APRA's October 2021 Information Paper that outlines the findings from APRA's superannuation thematic reviews and hence we understand APRA's rationale regarding the importance of interim valuations, specifically to promote member equity. The need to undertake interim valuations for unlisted assets is a problem faced by a small number of defined contribution superannuation systems globally and to our knowledge there is currently no industry accepted framework to manage what can at times be a challenging issue. JANA notes that it is therefore very important that APRA's guidance around interim valuations is clear to ensure RSEs uplift standards appropriately.

We have set out our interpretation of the guidance in SPG530 to ensure it aligns with APRA's. Our understanding is as follows:

- An interim valuation is required when the speed and magnitude of an event means that an interim valuation of an unlisted asset(s) is appropriate to aid member equity.
- An interim valuation should be able to be sourced by the RSE or the asset manager upon reasonable request by clients.
- Any trigger is for the review of the valuation of the asset rather than necessarily being the methodology for undertaking the revaluation.
- A trigger being hit does not necessarily mean a revaluation is undertaken.
- A trigger may be quantitative in nature. For example, a trigger may be based on a listed market index subject to the RSE demonstrating the index is appropriate.
- A trigger may also be qualitative in nature. It is not possible for every situation that may require an interim valuation to be described quantitatively and therefore the framework will likely describe broad scenarios, e.g., the change in government policy settings noted in paragraph 112.
- A trigger being hit would be the catalyst for analysis to determine whether an interim valuation is appropriate. There are different methodologies for determining how an interim valuation may be undertaken. These methodologies will likely differ by asset class.
- The framework should incorporate the process for determining when interim valuations are no longer required.

JANA is supportive of the high level, principle-based approach taken, however, we consider there is the risk that some market participants may misinterpret APRA's intentions, for example, interpreting that listed proxies should be used to determine how the interim valuation is undertaken (noting that JANA believes listed proxies may be useful for some but not all asset classes). We propose that APRA considers expanding the guidance for interim valuations to ensure industry participants are clear regarding APRA's intentions.

JANA believes that improving governance around unlisted asset valuations (particularly from a member equity perspective) is one of the key areas APRA has looked to address with the changes to SPS530 and SPG530. JANA's research teams have expertise in all unlisted asset classes, and we would be delighted to discuss this topic further if APRA would find it helpful.

Guidance for direct investments versus investments via an external fund manager

JANA notes that RSEs can access unlisted asset exposure in several ways, including investments in third party fund manager pooled funds and/or vehicles, and investing in the asset directly. JANA believes that high quality valuation governance frameworks will vary depending on how the RSE accesses the unlisted asset class. In general, if an asset is owned directly, it is important for an RSE to have a framework covering the facets described in paragraphs 95-112 of the draft SPG530. Where an RSE accesses the unlisted asset class via a third-party fund manager the focus should be on the RSE conducting sufficient due diligence into the framework used by the fund manager rather than the RSE having ownership of the framework.

We note that the current draft SPG530 is generally worded from the perspective of RSEs that own the asset directly. We believe it would be beneficial for SPG530 to clarify the difference in requirements based on the operating model in place.

Next Steps

Thank you for the opportunity to provide our feedback. As noted above, we would be delighted to discuss further any of the points raised in this consultation response.