

Superannuation (prudential standard) determination No. 2 of 2022

EXPLANATORY STATEMENT

Prepared by the Australian Prudential Regulation Authority (APRA)

Superannuation Industry (Supervision) Act 1993, section 34C

Under subsection 34C(1) of the *Superannuation Industry (Supervision) Act 1993* (the Act), APRA has the power to determine standards (prudential standards), in writing, in relation to prudential matters to be complied with by all RSE licensees of registrable superannuation entities (RSEs). Under subsection 34C(6) of the Act, APRA may, in writing, vary or revoke a prudential standard.

On 18 November 2022, APRA made Superannuation (prudential standard) determination No. 2 of 2022 (the Instrument) which revokes *Prudential Standard SPS 530 Investment Governance* (existing SPS 530) made under Superannuation (prudential standard) determination No. 8 of 2012 and determines a new *Prudential Standard SPS 530 Investment Governance* (SPS 530).

The instrument commences on 1 January 2023.

1. Background

APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they can meet their financial promises to depositors, policyholders and fund members within a stable, efficient and competitive financial system.

APRA carries out this mandate through a multi-layered prudential framework that encompasses licensing and supervision of institutions. APRA is empowered under the Act to issue legally binding prudential standards that set out specific prudential requirements for RSE licensees. These standards are supported by prudential practice guides which clarify APRA's expectations with regard to prudential requirements.

In November 2012, APRA issued a package of prudential standards related to superannuation. This included existing SPS 530 which was effective from 1 July 2013.

In 2018-2019, APRA undertook a post-implementation review (PIR) of its superannuation prudential framework, which included review of the investment governance requirements and guidance. The PIR identified several opportunities to enhance existing SPS 530 to ensure it remains fit for purpose.

Between September 2020 and March 2021, APRA also conducted a thematic review of unlisted asset valuation practices (Unlisted Asset Valuation Thematic Review) to assess industry practices and identify areas for improvement. The findings from the PIR, the Unlisted Asset Valuation Thematic Review, and APRA supervisors' observations of investment governance practices more broadly, highlighted the need for improvement in three key areas: stress testing, valuation and liquidity management practices.

2. Purpose and operation of the instrument

The purpose of Superannuation (prudential standard) determination No. 2 of 2022 is to revoke and replace existing SPS 530 with a new version of the standard and set out, in SPS 530, revised prudential requirements for an RSE licensee with respect to prudently managing and monitoring investments on behalf of beneficiaries.

Existing SPS 530 has been revised to address the findings of the PIR, the Unlisted Asset Valuation Thematic Review, and amendments informed by APRA's observations of RSE licensee investment governance practices.

The key revisions to existing SPS 530 are centred on three areas – stress testing, valuation practices and liquidity management. The amendments to existing SPS 530 largely reflect the elevation of existing expectations within prudential guidance into requirements in the prudential standard. In summary, the new requirements include that an RSE licensee must:

- undertake a comprehensive stress testing program which includes the articulation of the roles and responsibilities of persons involved, the articulation of the methodology, objectives and assumptions used in stress testing, identification of circumstances when ad hoc stress testing may be needed, and processes to ensure stress testing data is reliable;
- ensure that the results of the comprehensive stress testing program are periodically reviewed by the Board, relevant Board committees and senior management and that the Board documents how such results have been used in decision-making;
- have a valuation governance framework to identify and manage valuation risk, including a Board approved valuation policy which outlines the roles and responsibilities of those overseeing and managing valuation processes and procedures, identifies when valuations are accepted, rejected or reassessed, identifies triggers for interim valuations and the frequency of valuations;
- in its liquidity management plan, outline the roles and responsibilities of persons responsible for the management and oversight of liquidity risk and outline key metrics to be periodically reviewed by the Board, relevant board committees and senior management; and
- implement liquidity stress testing as part of its comprehensive stress testing program.

In summary, SPS 530 is intended to support RSE licensees in implementing a sound investment governance framework in a manner consistent with the interests of beneficiaries and assist RSE licensees in ensuring that any risks related to the management of investments are appropriately considered and addressed.

Merits review

The prudential standards provide for APRA to exercise various discretions. Decisions made by APRA exercising those discretions are not subject to merits review. This is

because these decisions are preliminary decisions that may facilitate or lead to substantive decisions which are subject to merits review.

Under the Act, it is a condition on all RSE licences that the RSE licensee must comply with the RSE licensee law, which includes prudential standards. However, there are no penalties prescribed for breach of the prudential standards under the Act. Instead, an RSE licensee's breach of an RSE licence condition is a ground for APRA to make further, substantive decisions under the Act in relation to the RSE licensee. Those decisions are, as the case may be, decisions to:

- a) cancel a licence to operate an APRA-regulated superannuation fund (section 29G of the Act); and
- b) issue a direction to the RSE licensee, including a direction to comply with the whole or part of a prudential standard (section 131D of the Act).

It is only at this stage that an RSE licensee is exposed to a penalty: loss of licence or 100 penalty units each day if it breaches the direction (section 131DD of the Act).¹ A subsequent substantive decisions of APRA to cancel the licence and impose a direction are subject to merits review.

Exemption from sunseting and disallowance

SPS 530 is exempt from disallowance in accordance with section 44(2)(b) of the *Legislation Act 2003* (Legislation Act) and regulation 9 of the *Legislation (Exemptions and Other Matters) Regulations 2015* (Legislation Regulations) as SPS 530 is an 'instrument (other than a regulation) relating to superannuation'.²

SPS 530 is exempt from sunseting in accordance with section 54(2)(b) of the Legislation Act and regulation 11 of the Legislation Regulations as this Legislative Instrument is 'an instrument (other than a regulation) relating to superannuation'.³

As SPS 530 falls within the above-mentioned exemptions to disallowance and sunseting, APRA does not have discretion to subject SPS 530 to disallowance and sunseting. To mitigate against any adverse impact arising from the above-mentioned exemptions from disallowance and sunseting, APRA undertook consultation on the proposed revisions to existing SPS 530 (refer to paragraph 3 for further details) and will continue to conduct regular reviews of SPS 530 which may include future PIRs

¹ Section 54B of the Act, provides that breach of a covenant under sections 52 or 52A is a civil penalty provision. The Investments covenants contained in section 52(6) of the Act does not include a requirement to comply with SPS 530.

² For paragraph 44(2)(b) of the Legislation Act, section 42 of the Legislation Act (disallowance of legislative instruments) does not apply to a legislative instrument in a class of legislative instrument referred to in an item of the table contained in regulation 9 of the Legislation Regulations. Item 3 of the table contained in regulation 9 of the Legislation Regulations provides that 'an instrument (other than a regulation) relating to superannuation' is a class of legislative instrument not subject to disallowance.

³ For paragraph 54(2)(b) of the Legislation Act, Part 4 of Chapter 3 of the Legislation Act (sunseting of legislative instruments) does not apply to a legislative instrument in a class of legislative instruments referred to in an item of the table contained in regulation 11 of the Legislation Regulations. Item 6 of the table contained in regulation 11 of the Legislation Regulations provides that 'an instrument (other than a regulation) relating to superannuation' is a class of legislative instrument not subject to sunseting.

and targeted reviews of specific requirements within SPS 530 within the sunset period.

Incorporation by reference

Where SPS 530 refers to provisions in an Act, this is a reference to an Act as it exists *from time to time*, and which is available on the Federal Register of Legislation at www.legislation.gov.au. Where SPS 530 refers to another superannuation prudential standard, the superannuation prudential standard referred to is the version that exists *at the time* the Instrument was determined, also available on the Federal Register of Legislation website.

3. Consultation

APRA undertook five months of public consultation between September 2021 and February 2022 on the proposed revisions to existing SPS 530 to enhance requirements relating to stress testing, valuation and liquidity management practices. In making final changes to existing SPS 530, APRA considered feedback from industry submissions in addition to the findings of the PIR and the Unlisted Asset Valuation Thematic Review as well as APRA supervisors' observations of investment governance practices more broadly.

Twelve submissions were received as part of the consultation and these submissions were broadly supportive of the proposed amendments. These submissions sought more detailed guidance to better reflect current investment practices and support the proposed new requirements in SPS 530. Submissions also called for guidance on the management of Environmental, Social and Governance (ESG) risks. In response, APRA plans to issue draft guidance to support the implementation of SPS 530. This proposed guidance will be the subject of consultation and will support the amendments to SPS 530. The proposed guidance will cover stress testing, liquidity management and valuation practices and how APRA expects RSE licensees to consider ESG factors as part of their overall management of investment risks.

APRA also made a number of minor amendments to SPS 530 to respond to submissions. These include clarifying that regular reporting to the Board does not have to include detailed reporting on individual investments where the Board approves appropriate measures and methodology to ensure timely Board reporting on adverse investment performance.

The consultation on SPS 530 consisted of the following releases:

- September 2021: Proposed revisions to *Prudential Standard SPS 530 Investment Governance*: letter and proposed revisions to draft SPS 530; and
- July 2022: Final revisions to SPS 530: letter and final SPS 530

4. Regulation Impact Statement

The Office of Best Practice Regulation has advised that they consider the amendments to SPS 530 are unlikely to have a more than minor regulatory impact, and

therefore the preparation of a Regulation Impact Statement is not required for this Legislative Instrument.

5. Statement of compatibility prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

A statement of compatibility prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* is provided at Attachment A to this Explanatory Statement.⁴

⁴ APRA is not obliged to prepare a statement given SPS 530 is exempt from disallowance, however, has nonetheless prepared one: see section 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ATTACHMENT A

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

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This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (HRPS Act).

Overview of the Legislative Instrument

The purpose of this instrument is to revoke *Prudential Standard SPS 530 Investment Governance* determined by APRA in 2012 and replace it with a new *Prudential Standard SPS 530 Investment Governance* (SPS 530). The instrument sets out prudential requirements for RSE licensees to implement a sound investment governance framework and to manage investments in a manner consistent with the interests of beneficiaries.

SPS 530 is being remade to strengthen the investment management framework by enhancing valuation practices and formalising stress testing and liquidity management practices to support RSE licensees in meeting their obligation to prudently select, manage and monitor investments.

Human rights implications

APRA has assessed the instrument against the international instruments listed in section 3 of the HRPS Act and has determined that the instrument does not engage any of the applicable rights or freedoms. Accordingly, in APRA's assessment, the instrument is compatible with human rights.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.