PRI RESPONSE

APRA CONSULTATION ON PRUDENTIAL STANDARD 515: STRATEGIC PLANNING AND MEMBER OUTCOMES

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PRI Association

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INTRODUCTION

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Australian Prudential Regulation Authority (APRA) consultation on proposed enhancements to Superannuation Prudential Standard 515: Strategic Planning and Member Outcomes (SPS 515).

ABOUT THIS CONSULTATION

On 1 August 2022, APRA released a discussion paper seeking feedback on proposed changes to SPS 515 (the Discussion Paper). SPS 515 and its accompanying guidance, SPG 515, were first introduced for the purpose of enhancing business planning practice. SPS 515 sets out requirements for RSE licensees to assess outcomes provided to members and identify opportunities to improve those outcomes, while undertaking sound strategic and business planning.

The proposed changes relate to defining member outcomes, sound management of resources and expenditure, assessing performance and taking action to improve member outcomes. Through this update, APRA intends to modernise the prudential architecture and deliver a more simplified, cohesive framework that provides RSE licensees clarity on their obligations and flexibility to meet them.

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KEY RECOMMENDATIONS

The PRI welcomes APRA's intention to enhance SPS 515 to improve the outcome setting and strategic planning process for RSE Licensees. The PRI is broadly supportive of the proposed changes. In addition, a further area of enhancement which APRA should consider relates to the strategic objective setting process. In particular, greater clarity and guidance should be provided in SPS 515 and the associated guidance about if and how RSE licensees should take into account system-level (market wide) risks[1] and, separately, the sustainability objectives of members.

System-level risks

To maintain and improve long-term financial performance in their beneficiaries' best financial interests, RSE Licensees have an implied duty to consider whether there are any sustainability-related system-level risks that may affect returns and, if so, how they can mitigate those risks.[2] Such risks are sometimes also referred to as market- wide risks. For RSE Licensees, whose highly diversified portfolios effectively represent a slice of the overall market, investment returns depend not only on decisions as to what to invest in, but on the stability and viability of environmental and social systems that the economy relies on. Many investors are now integrating such factors into their decision-making.

Despite rapidly developing investor practice in this area, APRA's regulatory framework currently does not explicitly support the integration of such considerations into governance, strategic planning, and objective setting processes. This emerging mismatch between market practice and the regulatory framework has the potential to lead to worse outcomes for members. Additionally, failure by RSE Licensees to comprehensively integrate such issues into their decision-making may create increased legal risks and expose RSE Licensees to accusations of 'greenwashing' if they address these issues in a piecemeal fashion.

Members' sustainability objectives

Separately to considerations in relation to system-level risks, investors both globally and in Australia are increasingly identifying and incorporating their members' sustainability objectives in their decisions. Currently, APRA's regulatory framework does not explicitly address how RSE licensees should take into account such objectives. Consideration should therefore be given to how SPS 515 and SPG 515 could be enhanced to better enable RSE licensees to incorporate members' sustainability objectives into their strategic objectives. This could help to improve member satisfaction and outcomes, align with global best practice, and reduce litigation risk and perceptions of 'greenwashing'.

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[1] 'System-level risks' is used here as a catch-all term for systematic risk and systemic risk, both of which have implications for investment performance. System-level risks can materialise from sustainability-related factors (i.e., sustainability-related system-level risks). One example of a sustainability-related systematic risk is the risk of reduced global economic growth due to sustained physical impacts of climate disruption; another is the opportunity cost associated with failing to meet the SDGs. An example of a sustainability-relate systemic risk would be a sudden repricing of assets across the fossil fuel sector, resulting in cascading defaults that destabilise financial markets – this is sometimes referred to as a potential "climate Minsky moment". See PRI (2022), A Legal Framework for Impact: Australia (p.6)

[2] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making.

Recommendations

To give effect to these enhancements, the PRI's key recommendations are:

- SPS 515 should be updated to ensure that RSE licensees are required to consider system-level risks (including sustainability-related system-level risks) when setting strategic objectives. Corresponding updates should be made to SPG 515, as well as the broader regulatory framework (e.g. updates to SPS 530).
- Both SPS 515 and SPG 515 should be enhanced to better support RSE licensees to assess members' sustainability objectives and incorporate them into their strategic objectives where that is consistent with members' best financial interests.
- To support robust processes and minimise risks of 'greenwashing claims' APRA should consider providing additional guidance on how RSE licensees can integrate the consideration of sustainability goals, impacts and outcomes into their decision-making, consistently with their existing duties.

DETAILED RESPONSE

This response is focused on Question 2 in Chapter 2 of the Discussion Paper:

Question 2. Has APRA correctly identified the areas for enhancement? What additional areas could benefit from enhanced requirements or guidance to support effective strategic planning and delivery of outcomes to members?

ADDITIONAL AREAS FOR ENHANCED REQUIREMENTS OR GUIDANCE

STRATEGIC OBJECTIVE SETTING

Better consideration of system-level sustainability risks

SPS 515 should be updated to ensure that RSE licensees are required to consider system-level risks (including sustainability-related system-level risks) when setting their strategic objectives. Corresponding updates should be made to SPG 530. Additionally, APRA should consider, and where permitted, pursue other related reforms necessary to maintain consistency in the broader legal and regulatory framework.[3]

As is the case for many large institutional investors with highly diversified portfolios, investment returns for RSE licensees depend not only on decisions as to what to invest in, but also on the stability and viability of environmental and social systems that the economy relies on.[4] To maintain

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[3] This should include updating investment governance standards to better reflect RSE licensee's obligations to consider and mitigate market-wide risks as outlined in the PRI's consultation response to SPS 530

[4] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making, PRI (2022), A Legal Framework for Impact: Australia.

and improve long-term financial performance in their beneficiaries' best financial interests, RSE licensees therefore have an implied responsibility to consider whether there are any sustainability-related system-level risks that may affect returns and, if so, how they can mitigate those risks.[5]

Many institutional investors globally, as well as in Australia, are recognising this reality and are increasingly integrating the consideration of such factors into their risk management, objective setting and investment decision-making frameworks. Accordingly, they are increasingly seeking to address system-level risks by setting and pursuing real-world sustainability goals through investment decisions, stewardship, and policy engagement.[6] By way of example, in PRI's 2021 annual reporting & assessment of signatories, 82 Australian signatories responded to an optional question on sustainability outcomes and of that number, 63 respondents (77%) stated that their organisation had chosen to shape sustainability outcomes in some way.

Although leading RSE licensees with strong responsible investment practices are beginning to consider system level risks and incorporate sustainability goals in their decision-making, broader market practice remains inconsistent. While many RSE licensees are increasingly considering environmental, social, and governance (ESG) factors, their approach is often limited to addressing ESG risks only at a narrower company or portfolio-specific level, rather than at a broader system-level.

To the extent that SPS 515 and the broader regulatory framework are silent on the need for RSE licensees to account for system-level sustainability factors, many RSE licenses may not sufficiently take these issues into account when setting strategic objectives. In these circumstances, their strategic focus may be limited to a focus on narrow asset or portfolio level issues, rather than taking into account broader financially material sustainability risks and goals at the system-level. In the long-term, this could negatively impact returns and undermine quality retirement outcomes for members.

In this respect, SPS 515 currently may not adequately reflect RSE licensees' duties to consider sustainability-related system-level risks, in the best interests of their beneficiaries.[7] It may also be inconsistent with APRA's guidance under CPG 229 – Climate Change Financial Risks to take a strategic approach to managing climate change risks, which is just one example of a sustainability-related system-level risk.

We therefore recommend that APRA consider appropriate mechanisms to better reflect these matters within the regulatory framework. For example, this could be done by adding a new subparagraph in paragraph 8(g) of SPS 515 that includes an explicit requirement for RSE licensee's to consider system-level risks when setting strategic objectives. This could also be accompanied by clarification and confirmation in SPG 515 that system-level risks can include sustainability-related risks such as

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[5] PRI (2022), A Legal Framework for Impact: Australia.

[6] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making, Australia Annex (p.163-165; 175-176).

[7] PRI (2021), A Legal Framework for Impact: Australia (p.12-15); Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making, Australia Annex.

climate change, biodiversity loss,[8] and rising inequality.[9] Further guidance could be provided regarding how RSE licensees integrate the consideration of such risks into their strategic objective setting process, and set appropriate sustainability goals and targets, in the best financial interests of their members.

Consideration of members' sustainability objectives

Additionally and separately to clarifying requirements for RSE licensees to take into account system-level risks, SPS 515 and SPG 515 should be enhanced to (1) better support RSE licensees in assessing members' sustainability objectives and (2) clarify that RSE licensees can incorporate members' sustainability objectives into their overarching strategic objectives where that is consistent with members' best financial interests.[10]

Investors globally, including a number of Australian superannuation funds, have undertaken surveys and other processes to identify, analyse and prioritise their members' sustainability objectives. These funds are then able to enhance their overarching strategic objective process with a clear understanding of members sustainability objectives, consistently with their legislative duties. Relevant reasons for doing so include the following:

1. **Member satisfaction**

Evidence increasingly shows that individual investors want their investments to contribute to positive or reduce negative sustainability outcomes in the real world.[11] Research by the Responsible Investment Association Australasia shows that 80% of Australians expect their investments to have a positive impact on the world.[12] Broader surveys have found that more than 50% of individual Australian investors are interested in realising positive change through their investments.[13]

Enabling RSE licensee's to identify member' actual sustainability objectives and take them into account when setting strategic objectives, rather than assuming members' interests, can help to build trust and increase satisfaction. In some cases, it can also lead to members contributing additional savings to their investment accounts, ultimately leading to better outcomes for their retirement.

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[8] ACSI (2021), Biodiversity: Unlocking natural capital value for Australian investors; WWF, Global Trade Analysis Project, Natural Capital Project (2020), Global futures: Assessing the global economic impacts of environmental change to support policy-making; ACF, Pollination, Australian Ethical (2022), The nature-based economy: How Australia's prosperity depends on nature; DeNederlandscheBank (2020), Indebted to nature: Exploring biodiversity risks for the Dutch financial sector .

[9] International Corporate Governance Network. (2019, June). *Investor framework for addressing systemic risks*; Organisation for Economic Co-operation and Development (2014), Growth and inequality: A close relationship?; PRI (2017), The SDG investment case.

[10] Members' sustainability objectives may be based on their values, ethics, aspirations, and/or priorities.

[11] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.56-60)

[12] These expectations can drive investment behaviours with 61% of Australians stating they would save and invest more if they knew their savings made a positive difference in the world. See Responsible Investment Association Australasia (2022), From Values to Riches 2022: Charting consumer demand for respons ble investing in Australia

[13] Fidelity International (2022). Fidelity survey: APAC investors' strong interest in sustainable investing continues, with a confidence challenge still to tackle

2. Global best practice

International trends show that investment regulations are beginning to require investors to assess beneficiary sustainability objectives.[14] The UK's Occupational Pension Scheme regulations, for example, requires trustees to specify the extent (if at all) to which they consider members' sustainability objectives in the selection, retention, and realisation of investments.[15] Recent amendments to EU frameworks also now require financial institutions to assess their clients' sustainability preferences prior to recommending financial products.[16] In order for Australia to maintain pace with global developments in relation to sustainable finance, stronger frameworks to support the consideration of beneficiary and client sustainability objectives will be required.

3. Reduce litigation risk and perception of greenwashing

In cases where there is a perception that sustainability risks and objectives are not being adequately taken into account, Australians are increasingly taking legal action against their superannuation funds for their approaches to sustainability issues like climate change.[17] Not only can it be costly for superannuation funds to respond to these claims, but in some cases, it can create ongoing reputational damage. Requiring RSE licensees to proactively consult members on their sustainability concerns and incorporate members' sustainability objectives into the RSE licensees' broader strategic objectives can help to minimise this risk. Proactive consultation by RSE licensees could ensure members are informed and better understand their RSE licensee's approach to addressing sustainability outcomes, thereby potentially reducing perceptions of greenwashing.

GUIDANCE ON APPROACHES TO PURSUE SUSTAINABILITY GOALS

In consultation with ASIC, APRA should also consider providing additional guidance on how RSE licensees can pursue sustainability outcomes through their investment decisions, stewardship, and policy engagement. We recognise that ASIC plans to oversee and investigate greenwashing by superannuation funds in their sustainability related disclosures and governance practices.[18] Despite ASIC's information sheet on how to avoid greenwashing in their communications,[19] there is a lack of regulatory guidance on if and how RSE licensees (and investors more broadly) should set and pursue sustainability related goals in their governance, strategic planning, and objectives setting processes.

Nevertheless, investors are rapidly developing various practices in this respect. If regulators do not set baseline expectations around the manner in which investors can credibly pursue sustainability

[14] PRI (2021) Understanding and Aligning with Beneficiaries' Sustainability Preferences; 2° Impact Investing (2022), Integrating client preferences for sustainable investments

[15] Regulation 2(3) of the Occupational Pension Schemes (Investment) Regulations 2005 (UK)

[16] EU Commission (2021), Amending Delegated Acts on sustainability preferences, fiduciary duties and product governance.

[17] For example, in 2018, Mark McVeigh filed a legal claim against REST for failing to address climate risks; in 2021, lawyers for QSuper members wrote to the fund requesting it strengthen its climate policies; in August 2022, lawyers for HESTA members wrote to the fund about greenwashing concerns for investments in fossil fuel companies.

[18] ASIC (2022), *Corporate Plan 2022-26: Focus 2022-23.*

[19] ASIC (2022), *Information Sheet 271 – How to avoid greenwashing when offering or promoting sustainability-related products.*

outcomes, there is a risk that RSE licensees may be exposed to accusations of greenwashing and face increased legal risks.

To support robust processes and minimise risks of 'greenwashing claims', we therefore encourage APRA to consider developing additional guidance on how RSE licensees can integrate the consideration of sustainability goals, impacts and outcomes into their decision-making, consistently with their existing duties. The PRI would welcome the opportunity to support APRA in the development of such guidance and refers to our existing resources including our Legal Framework for Impact reports, five-part framework on investing with SDG outcomes, and guidance on Active Ownership 2.0.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the Australian Prudential Regulation Authority to improve the strategic objectives set by RSE licensees, including sustainability goals.

Please send any questions or comments to policy@unpri.org.

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