

GOVERNANCE TOOLKIT

Investment Governance

Version 1: 1 August 2015



THIS TOOLKIT PROUDLY SUPPORTED BY

FRONTIER
ADVISORS



ai&st



Purpose of the Governance Toolkits

AIST has developed the Governance Toolkits to assist **Trustees** with maintaining strong prudential frameworks. They are created specifically to assist AIST members and are a benefit of membership.

The Toolkits contain functional tools such as diagrams, decision trees, flowcharts and checklists, to assist **Trustees** with understanding and applying their legal obligations, regulatory guidance and AIST governance guidelines.

How to use this Toolkit

The Investment Governance Toolkit is designed to assist **Trustees** with understanding and implementing the Superannuation Prudential Standard SPS 530 Investment Governance (SPS 530).

Tools

Obligations Map	shows the source of the Investment Governance requirements and how they interconnect with the broader regulatory framework
Implementation Flowchart	to implement Investment Governance obligations
Formulating an Investment Strategy	to help decide what is appropriate for the nature and complexity of the business
Checklists	<ul style="list-style-type: none"> - Develop an Investment Governance Framework - Portfolio Construction - Implementing an Investment Strategy - Maintaining an Investment Strategy - Investment Risk Management - Stress Testing - Liquidity Management
Dictionary	words in bold font are defined in a Dictionary at the back of the Toolkit. AIST recommends that members of the Board and other relevant staff familiarise themselves with the key concepts in the Dictionary.
Alerts	<p>Symbol  is used to identify a legal requirement established under SPS 530. It is expected that the Board is able to satisfy all of these legal requirements. If the answer is “NO” to any of the questions in the checklists, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue.</p> <p>Symbol  is used to identify an issue that needs particular care. It may denote:</p> <ul style="list-style-type: none"> - an issue or uncertainty arising from different, overlapping regulatory requirements; or - a matter that requires care in interpretation and application to a Trustee’s particular circumstances.
Workshops	<p>AIST recommends that Trustee directors consider attending training workshops to assist them with understanding the breadth and depth of their duties as regards investment governance.</p> <p>For more information about available workshops, contact AIST on 03 8677 3800.</p>

Warning & Disclaimer

The Toolkit is intended to assist **Trustees** but does not replace or exhaustively replicate primary sources of a **Trustee's** legal obligations, such as general law, legislation, regulations, prudential standards and regulatory guidance.

While the  symbol identifies issues requiring particular care, content without a symbol should not be regarded as any less significant. The **Trustee** will have to make its own judgements on how to apply the information in this Toolkit and should seek professional advice if uncertain.

Symbol  is used to identify a legal requirement established under SPS 530. It is expected that the Board is able to satisfy all of these legal requirements. If the answer is “NO” to any of the questions in the checklists, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue.

This Toolkit does not constitute legal advice and should not be relied upon to demonstrate compliance with any legal obligation or standard of conduct expected of **Trustees** or their directors. While this Toolkit is a valuable tool for a **Trustee** considering its obligations, it will not guarantee compliance or sound prudential outcomes.

Content in this Toolkit is adapted from the Australian Prudential Regulation Authority (**APRA**) Superannuation Prudential Standard SPS 530 – Investment Governance (July 2013) (SPS 530), and Prudential Practice Guide SPG 530 – Investment Governance (November 2013) (SPG 530). Compliance with SPS 530 only forms part of a Trustee’s legal obligations in respect of investment governance. The Toolkit does not comprehensively address the entirety of Trustees’ investment governance obligations under laws including but not limited to the *Superannuation Industry (Supervision) Act 1993 and the Corporations Act 2001*.

The information is current as at 1 August 2015. The Prudential Standards and Prudential Practice Guides can change and any changes made on or after 1 August 2015 will need to be taken into account.

Further assistance

If you would like further assistance, contact AIST at info@aist.asn.au or Frontier Advisors at GovernanceAdvisoryServiceTeam@frontieradvisors.com.au

Index

RSE licensee’s obligations.....	5
Obligations map.....	6
Implementation flowchart.....	7
Investment governance framework.....	8
Portfolio construction.....	14
Implementing an investment strategy.....	17
Maintaining an investment strategy.....	20
Investment risk management.....	23
Stress testing.....	26
Liquidity management.....	30
Dictionary.....	34

1. RSE licensee’s obligations

1.1 Investment Governance Framework

The RSE licensee is ultimately responsible for the sound and prudent management of the investments of each RSE in the RSE licensee’s business operations and must at all times have in place an Investment Governance Framework (Framework) for the selection, management and monitoring of investments. It must:

- a) Be appropriate to the size, business mix and complexity of its business operations; and
- b) Include the investment strategies for the whole of each RSE as well as each investment option.

The RSE licensee is ultimately responsible for the Framework and must ensure it is independently reviewed at least every three years.

1.2 Source of obligations

SPS 530 Investment Governance creates the obligation to have a Framework which includes, at a minimum, the formulation of specific and measurable investment objectives, formulation of risk and return objectives, an effective due diligence process, appropriate measures to monitor performance, processes to review and develop the **investment objectives and investment strategy** and formation of a liquidity plan.

A key requirement of the RSE licensee under SPS 530 is to formulate and implement an **investment strategy** for the whole of the RSE and for each investment option offered by the RSE licensee, taking into consideration (among other factors), the benefit structure of the RSE, the membership profile, the size, stability and growth rate in terms of assets under management, the tax position of the RSE and the broader financial markets.

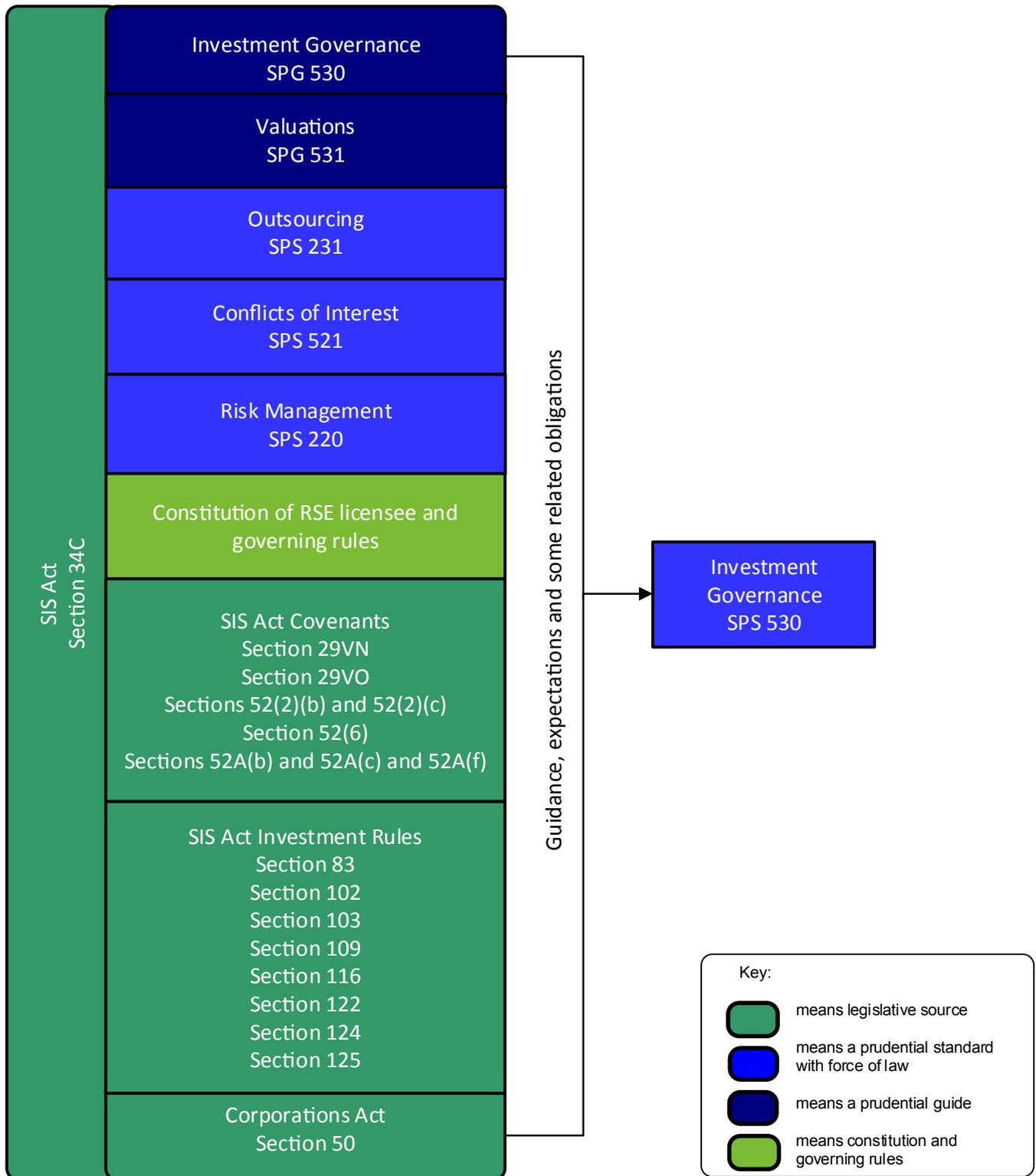
An RSE licensee would be expected to consider the amount of time, resources and expertise required to make informed investment decisions in the best interests of beneficiaries. Where an RSE licensee identifies any weaknesses in its capabilities in this regard, APRA expects the RSE licensee to strengthen its investment governance framework appropriately in those areas.

All investment-related roles must have documented responsibilities and reporting structures. This includes clearly identifying those roles involved in formulating investment strategies and those roles with decision-making responsibility in that process. The reporting structures of these roles should be appropriately reflected in the investment governance framework.

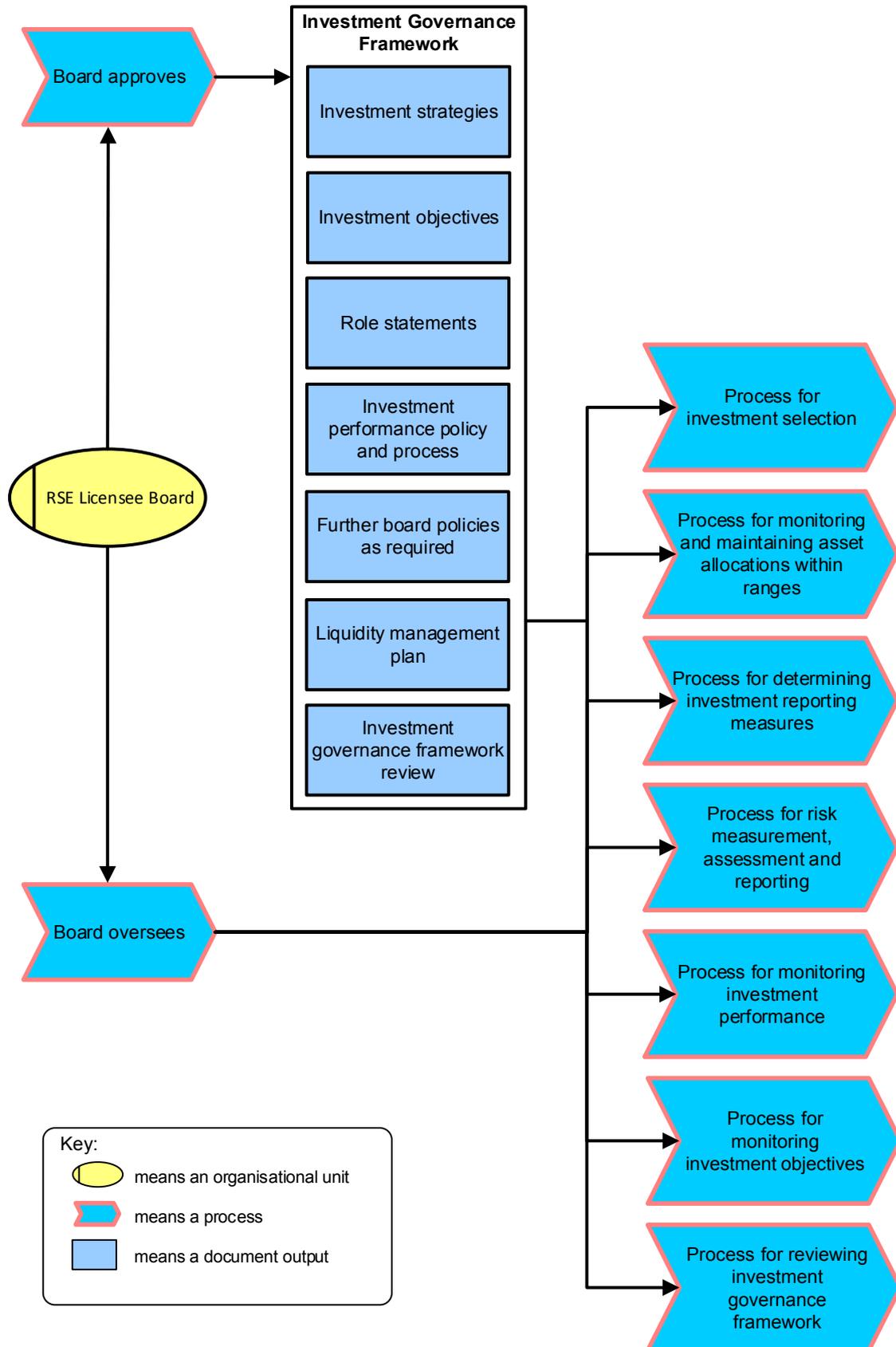
SPG 530 provides additional guidance for the implementation of SPS 530 and sets out APRA’s view of sound Trustee practice.

1.3 Obligations Map

The following Obligations Map sets out the breadth of sources from which obligations in relation to investment governance arise.



1.4 Implementation Flowchart



2. Investment Governance Framework

It is a legislative requirement that a **RSE licensee** will comply with the requirements set out in SPS 530 in relation to its investment governance of its business operations. A failure to comply with this requirement may adversely impact an RSE licensee’s MySuper authorisation.

The following checklists provide a valuable tool for the **RSE licensee** to develop its investment governance policy. Not all practices outlined in this checklist will be relevant for every **RSE licensee** depending on their size, business mix and complexity. An **RSE licensee’s** investment governance framework must be appropriate to the size, business mix and complexity of the **RSE licensee’s** business operations.

The diagram below summarises all areas of Investment Governance that are governed by SPS 530 and detailed in SPG 530. This toolkit aims to cover all of the commonly relevant requirements. It is advised that the **RSE licensee** seeks specific advice on sections not covered below if it applies to them. The **Board** of an **RSE licensee** is ultimately responsible for the sound and prudent management of the investments within the **RSE**.

Investment Strategy – Formulate and implement the investment strategy.
Investment Objectives – Return objectives, risk objectives, diversification, use of derivatives, cost and tax considerations and ESG.
Portfolio Construction – Asset allocation, modelling asset allocation, risk budgeting and lifecycle investment strategy (if applicable).
Maintaining an Investment Strategy – Asset allocation rebalancing, derivatives exposures, currency exposures, managing transitions of investments, monitoring investments and reviewing an investment strategy.
Investment Risk Management – Investment risk assessment, investment risk management approaches, investment risk reporting and review of investment risk management arrangements.
Stress Testing – Methodology of stress scenarios and risk factors, assumptions, frequency, reporting and review.
Liquidity Management – Liquidity management plan, management of liquidity risk, liquidity management reporting and liquidity stress testing.

The following sections have been excluded from this checklist:

- Environmental, social and governance issues within an investment strategy;
- Modelling asset allocation and lifecycle investment strategy;
- Conflicts of interest; and
- Managing transition of investments.

2.1 Develop an Investment Governance Framework

The following checklist will assist the **Trustee** in assessing whether its investment governance framework complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

The following checklists are designed to assist the RSE licensee in complying with its requirements in relation to the formulation and implementation of investment objectives and an investment strategy. The RSE licensee is expected, in a general sense, to outline prudent practices in relation to corresponding investment risk management arrangements.

An investment governance framework is the totality of systems, structures, policies, processes and people to address the **RSE licensee's** responsibilities with regard to investments. This includes generating returns to meet investment objectives while managing and monitoring all identified sources of investment risk. The **Board** is ultimately responsible for the investment governance framework.

BOARD SIGN-OFF	YES/NO
(a) Is the Board satisfied that the RSE has the appropriate resources and expertise required to adequately support the investment governance framework to manage investments and meet the RSE licensee's obligation to beneficiaries at all times?	
(b) Does the investment governance framework contain all Board policies relating to investment activities? 	
(c) Is the Board satisfied that roles that involve formulating investment strategies and roles that have decision-making responsibilities are operationally independent?	
(d) Is the Board satisfied that the responsibilities and reporting structures of each role are clearly reflected in the investment governance framework? 	
(e) Does the Board have a review process to ensure that its investment governance framework remains effective? 	
(f) Does the Board have the ability to take appropriate and timely action regarding information contained in reports on investment matters? 	
(g) Does the Board allow for a comprehensive review of the appropriateness, effectiveness and adequacy of its investment governance framework by an operationally independent, appropriately trained and competent person at least every three years? 	
(h) Does the scope of the investment governance framework review give regard to the following:	
i. The size, business mix and complexity of the RSE licensee's business operations? 	
ii. The extent of any changes to the business operations? 	
iii. Any changes to the external environment in which the RSE licensee operates? 	
(i) Is the Board satisfied that the RSE licensee's investment governance framework reflects the risks associated with investments as a material risk area identified in Prudential Standard SPS 220 Risk Management? 	
(j) Is the RSE licensee part of a corporate group that utilises group policies or functions? <i>If no, continue to question (k).</i>	
i. Has the Board approved the use of group policies and functions? 	
ii. Does the Board ensure that these policies and functions give appropriate regard to the RSE licensee's business operations? 	

PEOPLE **YES/NO**

(k) Is the **RSE licensee** satisfied that it has the appropriate skills, expertise and resources required to make informed investment decisions in the best interest of **beneficiaries**? 

 *APRA expects that the RSE licensee considers this commensurate with the complexity of the investments in which it has invested. This may be achieved in part by obtaining external advice.*

(l) Does the **RSE licensee** have clearly defined responsibilities and reporting structures documented for all investment-related roles? 

(m) Does the RSE licensee have procedures to ensure that all persons in roles related to investment activities of the RSE licensee are made aware of, and have processes and controls for monitoring compliance with, the RSE licensee’s investment governance framework? 

PROCESSES – DEVELOPMENT AND CONSTRUCTION **YES/NO**

(n) Is there an **investment strategy** for the whole RSE? 

 *This is described as the RSE licensee’s plan for determining the collection of investment options offered to **beneficiaries**.*

(o) Are there individual investment strategies for each investment option? 

(p) Has the **RSE licensee** considered the following factors when developing the **investment strategy** for the whole **RSE**:

i. Benefit structure of the **RSE** (i.e. defined benefit, accumulation or hybrid)?

ii. Operating phase of the **RSE** (accumulation, withdrawal or a combination of the two)?

iii. Membership profile (membership growth/decline, age, occupational profile and reasonable expectations)?

iv. Financial position of the **RSE** (size, stability and growth in terms of assets under management)?

v. Tax position of the **RSE**?

vi. Broader state of financial markets and economies?

vii. Any relevant finding by experts or advisors regarding the circumstances of the **RSE**?

(q) Has the **RSE licensee** (for defined benefit funds or defined benefit sub-funds) considered the following factors in addition to the individual circumstances: *If the RSE licensee does not have a defined benefit fund or defined benefit sub-fund, continue to (r).*

i. Benefit design?

ii. Solvency position (including shortfall limit)?

iii. Relationship with employer sponsor?

iv. The probability of continued employer support via an appropriate plan?

v. The general economic climate?

vi. Assumptions for contribution levels?

vii. Assumptions for salary growth?

viii. Assumptions for investment earnings?

ix. Is actuarial advice on the suitability of the **investment strategy** required outside the statutory triennial review?

PROCESSES – DEVELOPMENT AND CONSTRUCTION

YES/NO

(r) Has the **RSE licensee** determined appropriate stress scenarios for each investment strategy that cover a range of factors that can create extraordinary losses or make the control of risk within the investment strategy difficult?

(s) Prior to its implementation, does the **RSE licensee** undertake stress testing based on the pre-determined stress scenarios to confirm that the strategy is appropriate?

(t) Has the **RSE licensee** included in the investment strategy, the criteria and selection process that is applied to determine whether an investment option is considered appropriate for beneficiaries?

(u) Does the **RSE licensee**, when formulating the investment strategy for the whole **RSE**, and for each investment option, document how it has regard to each of the factors in *section 52(6) of the SIS Act*?

The Board must formally review its investment strategy on an annual basis.

As best practice, the RSE licensee should also formally review its investment strategy whenever there is a significant change within the RSE or its external operating environment. The Board should also refer to its investment strategy each time it considers any new or modified investment to ensure that the portfolio remains consistent with the overall investment strategy.

PROCESSES – INVESTMENT AND RETURN OBJECTIVES

YES/NO

APRA expects due consideration to be given to the expected range of investment returns and risk objectives of the investment option when determining the investment horizon and benchmark (where relevant).

An RSE licensee’s methodology for determining the investment reporting measures must also support compliance with relevant reporting standards made under the Financial Sector Collection of Data Act 2001.

(v) Has the **RSE licensee** determined **investment objectives** that establish the desired investment outcome for each investment option?

(w) Has the **RSE Licensee’s** Board implemented a process to regularly monitor and assess whether the investment objectives are being met?

i. Is there a specific and measurable target investment return objective?

ii. Is there a specific and measurable target investment risk objective?

iii. Is there a specific and measurable target level of risk exposure?

iv. Are they aligned with the size, business mix and complexity of the RSE from which the investment option is offered?

v. Is it formally documented?

vi. Is it capable of being clearly communicated to beneficiaries?

vii. Have assumptions been made for salary growth?

(x) Does the **RSE licensee** sufficiently understand, and is it able to articulate, the level and sources of expected returns that an **investment strategy** is aiming to achieve, including the level and sources of risk accepted in order to achieve the expected returns?

(y) Does the **RSE licensee** have any direct investments where it is not practical to articulate the **investment objective**?

APRA expects the RSE licensee at a minimum, to describe the risk exposures and other characteristics.

PROCESSES – RISK OBJECTIVE	YES/NO
(z) Has the RSE licensee considered and clearly articulated a measurable investment risk objective for each investment option?	
(aa) Has it been articulated in a manner that would enable current and prospective beneficiaries to understand the likelihood that the return objective(s) of an investment option may not be achieved?	
(bb) Does the risk objective include reference to the potential variability of returns, such as: <ul style="list-style-type: none"> - No more than x negative investment returns over a period of y years – OR – - Maintain a tracking error below x percentage points over a period of y years relative to the risk objective benchmark? 	
(cc) Has the RSE licensee included any qualitative statements that express the level and sources of risk to which an investment option is exposed?	
<p>It is considered best practice that the RSE licensee considers its loss appetite in addition to the standard risk measure (SRM) which does not measure the size of a negative return, but only its occurrence. The SRM is a narrow measure of risk and is best complemented by additional analysis.</p>	
PROCESSES – DIVERSIFICATION OF EACH INVESTMENT STRATEGY	YES/NO
(dd) When formulating each investment strategy , has the RSE licensee given due regard to the composition of investments within that investment strategy ?	
(ee) Do the investment options provided by the RSE licensee allow for adequate diversification?	
(ff) Has the RSE licensee identified the risk factors and sources of return with which the risk factors are associated?	
(gg) Has the RSE licensee determined the target exposure to the risk factors identified? 	
(hh) Is each investment strategy exposed to multiple sources of risk and return in a manner consistent with the interests of, and the RSE licensee’s duties to, beneficiaries?  <p><i>⚠ This includes but is not limited to, investing across multiple asset and sub-asset classes, counterparties and geographic regions, liquidity factors, and credit or macroeconomic risks where relevant. Where an investment option invests in a single asset class, it is expected that the RSE licensee ensures appropriate diversification within the particular asset class.</i></p>	
(ii) Has the RSE licensee determined which asset classes and/or individual assets it will invest in to achieve its desired risk exposure and whether making, holding or realising these investments can be done in a manner consistent with the interests of the RSE’s beneficiaries? 	
(jj) If the investment strategy is exposed to multiple assets and/or asset classes, has the RSE licensee identified how the sources of return are expected to interact, and the variability and impact this may have on the overall diversification of the strategy in different market conditions? 	
(kk) Has the RSE licensee implemented portfolio composition parameters to minimise a beneficiary’s exposure to an inherently undiversified investment option, such as direct investments, to ensure adequate diversification?	

PROCESSES – DIVERSIFICATION OF EACH INVESTMENT STRATEGY

YES/NO

- (II) Does the **RSE licensee** offer a MySuper product option? *If no, continue to Section 2.2 – Portfolio Construction.*
 - i. In addition to the requirements for formulating an **investment strategy**, does the **RSE licensee** document how the MySuper product is diversified over multiple risk factors and sources of return as required in the **SIS Act**? 
 - ii. Does the RSE licensee document how its MySuper product complies with sections 29VN(d)(i) and 29VN(d)(ii) of the **SIS Act**? 
 - iii. Can the RSE licensee demonstrate compliance with rules for the relevant permissible fees in a MySuper product? 
 - iv. Has the **RSE licensee** explicitly considered the diversification and **liquidity** needs of the MySuper product relative to the membership profile and the absolute and relative size of the product to the **RSE**?

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

2.2 Portfolio Construction

The following checklist will assist the **Trustee** in assessing whether its **investment strategy**, irrespective of which asset allocation technique is used, complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

APRA considers portfolio construction a crucial step in the process of **investment strategy** formulation and is required for the RSE licensee to achieve its stated **investment objectives**.

There are additional requirements for **RSE licensees** who offer a lifecycle **investment strategy** which are outside the scope of this Toolkit.

APRA expects that a prudent **RSE licensee** would undertake appropriate analysis to demonstrate that adopting a strategy is in the best interest of its **beneficiaries**.

BOARD SIGN-OFF	YES/NO
(a) Does the Board receive adequate and regular reporting on the performance of each investment, including if it is required to make any changes to the asset allocation targets and ranges?	
(b) Is the Board satisfied that there is a systematic approach, with clearly defined risk objectives, for appropriate asset allocation across various asset classes? 	
PROCESSES – ASSET ALLOCATION	YES/NO
(c) Does the RSE licensee have an investment option that involves more than one asset?	
i. Has the RSE licensee determined asset allocation targets and ranges to achieve the investment objective for the investment option?  <i>⚠️ If the investment option is externally managed, an RSE licensee is expected to assess the reasonableness in its due diligence process.</i>	
(d) Irrespective of which asset allocation technique is used, does the RSE licensee adopt a formal approach to determining the asset allocation by establishing the following:	
i. An initial target asset allocation for each asset class? 	
ii. Asset allocation ranges for each asset class? 	
iii. The basis on which asset allocation targets and ranges would be changed? 	
iv. An investment horizon and investment objective for the investment option(s)?	
v. A list of permissible investment types?	
(e) When determining the list of permissible investment types, has the RSE licensee considered the following factors:	
i. The nature and characteristics of the types of asset, including the consistency with the risk and return objectives for the strategy?	
ii. Do the range of assets facilitate the construction of an investment strategy to achieve the investment objectives ?	
iii. Has the RSE licensee considered what would happen in the event that any potential changes in the circumstances of the RSE could render certain types of assets inappropriate?	

PROCESSES – STRATEGIC ASSET ALLOCATION (SAA)

YES/NO

- (f) Has the **RSE licensee** set asset allocation ranges at levels which allow for movements of the actual asset allocation due to normal market fluctuations?
- (g) Has the **RSE licensee** set the ranges so that they are not so wide or narrow that they render the strategy unconstrained or ineffective?
*⚠️ APRA considers this particularly important for **RSE licensees** to consider, in order to avoid the portfolio from becoming too constrained.*
- (h) Does the **RSE licensee** monitor the ranges so that it can identify and respond in a timely manner to any significant deviation from the **investment strategy**?

PROCESSES – DYNAMIC ASSET ALLOCATION (DAA)

YES/NO

- (i) Has the **RSE licensee** adopted a formal policy that governs the asset allocation process?
- (j) Does the policy include the following considerations:
 - i. Permitted **dynamic asset allocation** ranges and other investment exposure limits?
 - ii. Factors and conditions that would lead to changes in either the target asset allocation or the asset allocation ranges?
 - iii. How the approach meets the goals of the sub-fund (where applicable)?
 - iv. Approval process for changes to the asset allocation target and ranges?
 - v. The reporting requirement of any changes to the asset allocation targets and ranges to the **Board** and relevant sub-committees?

PROCESSES – TACTICAL ASSET ALLOCATION (TAA)

YES/NO

- (k) Does the **RSE licensee** have a policy to employ a **tactical asset allocation** approach?
- (l) Can the **RSE licensee** demonstrate the development of a sound process to support the use of **tactical asset allocation**?
- (m) Can the **RSE licensee** demonstrate clearly the differences between dynamic and **tactical asset allocation** decisions where both are used?

PROCESSES – RISK BUDGETING

YES/NO

Risk budgeting can be used to determine the optimal asset allocation of an investment option within a risk-based framework. Risk budgeting considers how different risks drive the returns of different asset classes and derives the optimal asset allocation based on the expected return per unit of risk of each of those asset classes. However, risk budgeting does not allow for prospective returns and so is commonly considered as a support tool for decision making rather than a pre-requisite for asset allocation. APRA does not require RSEs to have a risk budget.

- (n) If the **RSE licensee** does have a risk budget, is there a process in place for the **RSE licensee** to regularly review the impact of market movements on its risk allocation and the subsequent implications for the rest of the asset allocation of an investment option?

PROCESSES – ASSET ALLOCATION REBALANCING
YES/NO

SPS 530 requires that each investment strategy includes a policy to monitor and maintain the asset allocation within the determined ranges and within a reasonable timeframe. This applies equally to RSE licensees whether they adopt a strategic or dynamic asset allocation approach. 

- (o) Does the **RSE licensee** offer an internally developed investment option for managing the asset allocation using either a **strategic or dynamic asset allocation** approach?
- (p) Does the **RSE licensee** have a clearly documented policy to manage its asset allocation which covers the following matters: 
- i. Basis for any change to the asset allocation?
 - ii. Method of rebalancing?
 - iii. Triggers for rebalancing?
 - iv. Permitted use of derivatives in order to rebalance?
 - v. Reporting arrangements to approve and confirm any changes to the asset allocation or rebalancing?
- (q) Is the **RSE** able to implement rebalancing without incurring significant costs to the investment option, both under normal operating circumstances and under a range of stressed scenarios?
-  *If the **RSE** adopts a **strategic asset allocation** approach and there is a significant divergence from the stated asset allocation, **APRA** expects that a prudent **RSE licensee** would consider timely disclosure of the divergence to its **beneficiaries**. Such disclosure may include information regarding how the **RSE licensee** intends to return the portfolio to its **strategic asset allocation**, including the timeframe within which it intends to do so.*
- (r) Does the **RSE licensee** offer an **externally managed** investment option?
- (s) Does the **RSE** review the asset allocation of that option to determine whether it has deviated substantially from the stated asset allocation target?
- (t) In the case of an identified deviation, does the **RSE** have a process to assess whether the deviation may have a significant effect on the investment objective of the investment option being achieved?
-  *If the **RSE** determines the deviation to be significant, **APRA** expects the **RSE licensee** to consider options to address the deviation, including the appropriateness of continuing to offer the investment option to **beneficiaries**.*
- (u) Does the **RSE licensee** utilise an investment option within the **RSE** that serves as a **liquidity provider** to other investment options within the **RSE**?
- (v) Does the **RSE licensee** document its **liquidity provider** arrangement within its investment policies?
- (w) Is the **RSE licensee** able to demonstrate an understanding of the risk that may arise as a result of implementing **liquidity provider** arrangements?
- (x) Has the **RSE licensee** established appropriate controls to manage potential risks?

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

2.3 Implementing an Investment Strategy

The following checklist will assist the **Trustee** in assessing whether its process and criteria for selecting each investment is appropriate in order to give effect to the **investment strategy** and to comply with the minimum requirements in SPS 530 and with the guidance provided in SPG 530. The criteria are expected to be reflected in the **RSE's** due diligence process and should be undertaken prior to the selection of the investment.

BOARD SIGN-OFF	YES/NO
(a) Is the Board satisfied that through its due diligence process that it has a robust understanding of each investment?	
(b) Are all actual and potential conflicts of interest appropriately documented? <i>⚠️ Prudential Practice Guide SPG 521 Conflicts of Interest provides further guidance for identifying, avoiding and managing conflicts.</i>	
(c) Is the Board satisfied with its understanding of the fee structure for all investments and believes it to be most appropriate?	
PEOPLE	YES/NO
<i>Where an RSE conducts investment management or trading functions (including derivatives trading) in-house, APRA expects that the RSE licensee would establish appropriate segregation of duties to ensure that trading, risk management and settlement functions are operationally independent.</i>	
(d) Does the RSE licensee have operationally independent business functions as appropriate for the nature and complexity of the business?	
PROCESSES – DEVELOPMENT AND CONSTRUCTION	YES/NO
(e) Does the RSE licensee have an established process and criteria for selecting each investment (also known as an investment selection process)? 📖	
(f) Is the RSE licensee's investment selection process criteria, reflected in its due diligence process, undertaken prior to the selection of an investment for an investment option? 📖	
(g) Does the RSE licensee have sufficient understanding and knowledge of each investment selected, including the assessment of any other factors that could have a material impact on achieving the RSE's investment objectives of the investment option? 📖 <i>⚠️ APRA considers a prudent RSE licensee would develop an understanding of each proposed investment through a robust due diligence process. Guidance on the due diligence process is covered below in question (n).</i>	
(h) Does the RSE licensee have sufficient understanding of how each investment is expected to perform under a range of stress scenarios? 📖	
(i) Is the RSE licensee satisfied that the investment is appropriate for the investment option? 📖	
PROCESSES – DUE DILIGENCE OF INVESTMENTS	YES/NO
(j) Is the level of due diligence appropriately reflected in the nature and characteristics of each proposed investment?	
(k) Are the outcomes of the due diligence assessments documented for each investment?	
(l) If the due diligence was outsourced, did the RSE licensee apply an equally robust due diligence process when selecting and appointing the outsourced manager?	

PROCESSES – DUE DILIGENCE OF INVESTMENTS	YES/NO
(m) Has the RSE licensee determined the most appropriate approach to due diligence (in-house or via external consultant) based on its own resources and the available skill, knowledge and understanding required?	
(n) Has the RSE licensee's due diligence process assessed the following areas:	
i. The industry in which the investment operates and the current environment?	
ii. The projected performance of the investment?	
iii. The identified risk factors (including derivative risk exposure) which the investment may be exposed to?	
iv. The valuation methodology of the investment?	
(o) Does the investment involve unlisted equities? If so, has the RSE licensee's due diligence process assessed the following areas:	
i. The ownership structure, including information regarding the Board membership and the senior management personnel?	
ii. The organisation's business plan?	
iii. Financial analysis of any private market for the investment?	
iv. Any future commitments required?	
v. Any lock-up periods, including any restrictions on the ability to exit the investment?	

PROCESSES – DUE DILIGENCE OF INVESTMENT MANAGERS	YES/NO
<p><i>APRA Prudential Standard SPS 231 Outsourcing provides further requirements that RSE licensees must follow when contracting with investment managers. These requirements are not necessarily addressed in this Toolkit. We recommend that all RSE licensees consider the requirements under SPS 231 and APRA's expectations under SPG 231 Outsourcing.</i></p>	
<p>⚠️ APRA considers that the investment management arrangement between the RSE licensee and investment manager would ordinarily specify the functions to be delegated to the manager. However, the RSE remains ultimately responsible for the sound and prudent management of the investments of each RSE.</p>	

(p) Is the RSE licensee able to demonstrate appropriate analysis supporting its due diligence assessment of a prospective investment manager prior to selection of the investment manager?	
(q) Does the RSE licensee assess any of the following when completing its due diligence assessment of prospective investment manager(s):	
i. The investment strategy and approach to investment portfolio composition?	
ii. How the investments are managed, including the management of market and investment risk factors?	
iii. Approach, quality and extent of the research, due diligence and investment process, including the expertise of investment staff?	
iv. A record of previous performance and the expected future performance as determined by the risk and return measures through various cycles?	
v. The investment risk management in place and the quality and timeliness of the investment risk reporting?	

PROCESSES – DUE DILIGENCE OF INVESTMENT MANAGERS		YES/NO
vi.	The approach, quality and timeliness of the investment valuation, monitoring and reporting process (including downstream investments)?	
vii.	The methodology, frequency and approach for reviewing, analysing and reporting stress testing results?	
viii.	The approach and quality of liquidity management arrangements?	
ix.	The systems, policies and processes in place to monitor and manage operational risk exposures?	
(r)	Has the RSE licensee set out the required investment parameters or constraints with the investment manager?	
(s)	Has the RSE licensee established performance standards and benchmarks with the investment manager?	
(t)	Does the RSE licensee have a documented process for regularly monitoring and reviewing the investment manager’s performance?	
PROCESSES – PERFORMANCE BASED FEES		YES/NO
(u)	Has the RSE licensee considered the impact of performance-based fees on the overall return of an investment strategy ?	
(v)	Does the RSE licensee sufficiently understand the fee structure attached to the investment?	
(w)	Does the RSE licensee sufficiently understand how the performance-based fees impact the return objective of the investment strategy ?	
(x)	Does the RSE licensee sufficiently understand how various market cycles may impact on the performance-based fees?	

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

2.4 Maintaining an Investment Strategy

The following checklist will assist the **Trustee** in assessing whether its **investment strategy** complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

SPS 530 requires **RSE licensees** to have a policy to monitor and maintain its asset allocation within the determined ranges, and within a reasonable timeframe, irrespective of whether the **RSE licensee** adopts a **strategic or dynamic asset allocation** approach.

If the **RSE licensee** offers an internally developed investment option to manage the asset allocation rather than using either a **strategic or dynamic asset allocation** approach, **APRA** expects that the **RSE licensee** will have a sound policy to maintain the investment option. This policy should include the basis, method and triggers for rebalancing; permitted use of derivatives in order to rebalance; and the arrangements in place to approve, confirm and report on any changes to the asset allocation or rebalancing to the **Board**.

BOARD SIGN-OFF

YES/NO

- (a) Does the **Board** receive, at least annually, results of the **investment strategy** review against its **investment objectives**? 

 **APRA** expects that the details provided in the reporting is sufficient for the **Board** to satisfy itself that a comprehensive review has been undertaken and that any amendments to an **investment strategy** have been thoroughly considered and analysed.

It is generally considered to be best practice for the Board to also review its investment strategy on each occasion there is a significant change in the external or internal operating environment.

- (b) Is the **Board** satisfied that there is appropriate reporting on the monitoring of investment performance, reflective of the type, complexity and amount of investment, and that the reporting is sufficient to satisfy adequate oversight of the investment? 
- (c) Is the **Board** satisfied that persons assessing the performance of each investment are operationally independent from those carrying out investment activities? 
- (d) Does the **Board** have formal triggers for an interim review of the **investment strategy** in addition to the annual **investment strategy** review? 

PROCESSES – DERIVATIVES EXPOSURE

YES/NO

- (e) Does the **RSE licensee** have sufficient mechanisms in place to capture, monitor and manage potential risk associated with the use of derivatives within its **investment strategy**?

 **APRA** expects a prudent **RSE licensee** to consider risks such as **liquidity risk, basis risk, rollover risk and counterparty risk, amongst other things**.

- (f) Has the **RSE licensee** formalised and documented limits that ensure any risks arising from derivatives exposure are managed within its established risk tolerances?
- (g) Does the **RSE licensee** receive regular and timely reporting on its derivatives exposure, including any mandate breaches as appropriate?

PROCESSES – CURRENCY EXPOSURES

YES/NO

- (h) Does the **RSE licensee** have mechanisms to adequately address the potential risks arising from foreign currency exposures within its **investment strategy**?
- (i) Are these mechanisms appropriately documented and monitored?
- (j) Does the **RSE** regularly report on the management of its foreign currency exposure?

PROCESSES – CURRENCY EXPOSURES	YES/NO
(k) Does the regular reporting include the current foreign currency exposures within the investment strategy ?	
(l) Does the regular reporting include the contribution of foreign currency exposures to investment returns over the investment period?	
(m) Does the regular reporting include hedge positions that are currently in place and the cost involved in maintaining those hedges?	
(n) Does the regular reporting include performance of hedging strategies against the objectives?	
(o) Does the regular reporting include counterparty exposures arising from the hedging strategy?	
(p) Does the RSE licensee regularly monitor the liquidity impact of maintaining a hedging strategy (including a sudden move in the rate of foreign currency) for each investment option?	
PROCESSES – MONITORING INVESTMENTS	YES/NO
(q) Does the RSE licensee regularly report on the monitoring of investment performance to the Board and senior management?  <i>⚠️ APRA expects that the frequency and style of reporting should be reflective of the type, complexity and amount of investment, and is sufficient to satisfy adequate oversight of the investment.</i>	
(r) Does the RSE licensee have a process in place to measure and report on the performance of each investment in each investment option and each MySuper product on an ongoing basis?  <i>⚠️ RSE licensees with any externally managed investment options are expected to implement appropriate arrangements to monitor the performance of that option in line with its own investment objectives.</i>	
(s) Does the RSE licensee’s monitoring process use appropriate, pre-determined benchmarks and/or performance measurement criteria to evaluate investments and investment managers?	
(t) Is the performance monitoring objective and measurable, and does it exhibit characteristics that are consistent with those of the investment or the style of the investment manager being measured?	
(u) Is the performance monitoring objective formally documented?	
(v) Does the RSE licensee’s reporting include relevant information in appropriate detail to enable the RSE licensee to sufficiently understand and adequately monitor the sources of risk and return? <i>⚠️ For example, an RSE licensee may analyse the sources that contribute to the outperformance or underperformance to assist in its assessment of investment strategies and specific investments.</i>	
(w) Does the RSE licensee measure the performance attributable to decisions to shift the asset allocation against relevant benchmarks and the investment objectives ?	
(x) Does the RSE consider all actual or proposed changes within the RSE licensee’s business operations and in the external environment? Such situations may include but are not limited to the following:  i. Sudden unexpected growth or reduction in membership ? ii. Changes in membership profile? iii. Unusual movement of members between investment options? iv. Changes to the benefit design? v. Changes to the liquidity status of underlying investments?	

PROCESSES – MONITORING INVESTMENTS	YES/NO
vi. Unusual patterns in investment performance given the nature of a particular investment and the prevailing market conditions?	
vii. Changes to the economic climate and the condition of specific markets?	
viii. Changes to, or within, relevant service providers, such as ownership, key personnel, systems and legacy system issues?	
ix. Legislative amendments that may impact on the investment strategy of a particular investment option, such as changes to retirement income standards or tax arrangements?	
(y) Does the RSE licensee have a process in place for managing investment options which have been identified as not performing in line with expected investment objectives ?	
(z) Does the RSE licensee have pre-determined measures for underperformance and the process to be undertaken if underperformance occurs?  <i>This may include steps that will be taken to address under-performance, limit the exposure, or other actions that are in the best interest of the beneficiary.</i>	

PROCESSES – REVIEWING AN INVESTMENT STRATEGY	YES/NO
(aa) Does the RSE licensee formally review each investment strategy at least annually to ensure that the investment strategy remains consistent with its investment objectives ? 	
(bb) Does the RSE licensee have a documented process for reporting results of a formal review to the Board and, if necessary, to adjust the investment strategy for any internally developed investment option that is no longer appropriate to meet the investment objectives ? 	
(cc) Does the RSE licensee have established triggers for interim reviews of the investment strategy ?   <i>Such triggers may include a significant economic event, a structural change in the membership profile, or a material outflow of beneficiary funds.</i>	
(dd) Does the RSE have a process in place to report the results of each review to the Board ?   <i>APRA expects that the details provided in the reporting is sufficient for the Board to satisfy itself that a comprehensive review has been undertaken. In addition, it is a requirement that any amendments to an investment strategy must be thoroughly considered and analysed with sufficient justification to support it.</i> 	
(ee) Does the RSE's review policy include the criteria that will determine whether the investment strategy must be changed? 	

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

2.5 Investment Risk Management

The following checklist will assist the **Trustee** in assessing whether its **investment risk** management arrangement complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

Investment risk in superannuation is the risk of an **RSE licensee** failing to meet its **investment objectives** due to adverse or inadequate investment performance. Despite the fact that **investment risk** is borne by **beneficiaries** in a defined contribution fund, or by employer sponsors in a defined benefit fund, an **RSE licensee** remains ultimately responsible for measuring and managing the **investment risk**.

Investment risk management should comprise of a range of tools for risk measurement and analysis that are commensurate with the size, business mix and complexity of the investments of the **RSE** and its investment options.

BOARD SIGN-OFF	YES/NO
(a) Is the Board satisfied that the investment risk management arrangement enables it to identify the likely manifestation of investment risk in order to prudently manage risk exposures that arise from the complexities of investment decision-making? 	
(b) Is the Board satisfied that the investment risk management arrangements comprise a range of tools for risk measurement and analysis that are appropriate for its size, business mix and complexity of investments and its investment options?	
(c) Does the Board review the appropriateness, effectiveness and adequacy of its investment risk management arrangements as part of the review of its investment governance framework? 	
PEOPLE	YES/NO
(d) Does the RSE licensee have appropriately documented segregation of duties between persons responsible for implementing investment decisions and persons responsible for investment risk management arrangements?	
PROCESSES – INVESTMENT RISK ASSESSMENT	YES/NO
(e) Does the RSE licensee have the structures, policies and processes in place for investment performance and risk measurement, assessment and reporting that is detailed in its investment governance policy? 	
<i>Questions (f) to (i) below provide guidance for RSE licensees on how this can be achieved.</i>	
(f) When assessing either an investment or investment manager has the RSE licensee undertaken a formal risk assessment?	
i. Did the risk assessment include identification of risk factors?	
ii. Did the risk assessment include the assessment and measurement of the identified risk factors, including the potential impact on the sources of investment return?	
iii. Did the risk assessment include the risk mitigation strategies in place?	
iv. Did the risk assessment include how the identified risks would be monitored and reported?	
(g) When actively considering investment risk during the formulation, implementation and performance monitoring of an investment strategy , has the RSE licensee considered the following factors:	
i. Which sources of investment risk to accept and the extent of the risk exposure during the formulation of the strategy?	
ii. Mechanisms for ensuring that the risk accepted is consistent with this decision during implementation?	

PROCESSES – INVESTMENT RISK ASSESSMENT	YES/NO
iii. The process for identifying, measuring and assessing the actual exposure to investment risk via performance monitoring?	
(h) When evaluating potential investment risks in an investment strategy , has the RSE licensee considered the risks that may arise from the following factors:	
i. Volatility – the level of movement in value of an investment option?	
ii. Maximum drawdown – a measure of the greatest decline in the value of the investment option?	
iii. Sequencing risk – the risk that timing of investment returns of an investment option adversely affect beneficiaries during a critical period in their investment horizon?	
iv. Inflation risk – the risk that investment option returns are not sufficient to maintain purchasing power?	
v. Tail risk – the likelihood of a low-probability, high-impact adverse event occurring?	
vi. Correlation risk – the risk of increasingly similar behaviour of investment returns amongst asset classes, reducing the benefit of diversification?	
vii. Liquidity risk – the inability to meet obligations as and when they fall due without incurring unacceptable losses?	
(i) Does the RSE licensee have documented criteria for investment risk exposures as part of its investment risk management arrangements?	
<p> <i>This would typically cover the extent to which an RSE licensee is prepared to expose an investment strategy to the investment risk factors and whether it would be in the best interests of its beneficiaries to establish any investment restrictions.</i></p>	

PROCESSES – INVESTMENT RISK MANAGEMENT APPROACHES	YES/NO
(j) Does the RSE licensee use a combination of the following approaches, including stress tests, when assessing and measuring the sources of risk that influence the returns attributable to an investment strategy :	
i. Factor risk analysis – to identify and measure the underlying risk factors that may influence the investment returns?	
ii. Risk budgeting – considers how different investment risks drive the expected returns of various asset classes?	
iii. Risk analysis – considers alpha and beta sources to assist in measuring the sources of risk in an investment strategy that are generated by active or passive investment decisions?	

PROCESSES – INVESTMENT RISK REPORTING	YES/NO
(k) Has the RSE licensee developed a methodology for determining investment reporting measures? 	
<p> <i>An RSE licensee's methodology for determining the investment reporting measures must also support compliance with relevant reporting standards made under the Financial Sector Collection of Data Act 2001.</i> </p>	
(l) Does the RSE licensee have a set of relevant investment risk indicators that enable it to monitor deviations from established tolerances for investment risk exposures?	
(m) Does the RSE have a formal escalation procedure for reporting identified deviations from tolerance levels?	

PROCESSES – INVESTMENT RISK REPORTING	YES/NO
(n) Does the RSE licensee provide regular investment risk reporting to appropriately inform relevant stakeholders of investment risk exposures so that they are in a position to make informed decisions in a timely manner?	
(o) Does the investment risk reporting provided by the RSE licensee include an appropriate level of detail and sufficient commentary to enable stakeholders to understand and adequately monitor the sources of investment risk ?	
(p) Does the RSE licensee provide enhanced reporting of its investment exposures with greater frequency and intensity during periods of heightened market volatility or increased idiosyncratic risk?	
(q) Does the RSE licensee’s investment risk reporting include the following: <ul style="list-style-type: none"> <li data-bbox="71 660 1356 728">i. Market and economic developments that may result in altered risk exposures? <li data-bbox="71 728 1356 784">ii. Investment option risk profiles as measured by risk metrics? <li data-bbox="71 784 1356 840">iii. Asset class risk profiles as measured by key risk indicators? <li data-bbox="71 840 1356 896">iv. Investment manager risk indicators? <li data-bbox="71 896 1356 929">v. Investment compliance and breach reporting? 	

PROCESSES – REVIEW OF INVESTMENT RISK MANAGEMENT ARRANGEMENTS	YES/NO
(r) Does the RSE licensee (or an external service provider) ordinarily review the appropriateness, effectiveness and adequacy of its investment risk management arrangements as part of the review of its investment governance framework?  <i>An RSE licensee that chooses to engage an external service provider to assist in some of its investment risk management arrangements still remains ultimately responsible for managing investment risk exposures within the RSE.</i>	
(s) If engaging with an external service provider, does the RSE licensee conduct a review of the external service provider’s performance against the criteria detailed in its written agreement?	

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

2.6 Stress Testing

The following checklist will assist the **Trustee** in assessing whether its stress testing program complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

APRA considers stress testing to be an effective **investment risk** management tool that may assist an **RSE licensee** to identify and assess potential risk exposures that may threaten the likelihood of achieving **investment objectives**. Stress testing can also be used to identify and assess potential risk exposures for each stage of a lifecycle investment strategy.

BOARD SIGN-OFF	YES/NO
(a) Is the Board satisfied that it has developed a comprehensive stress testing program which, at a minimum, includes the performance of each investment option against the RSE's pre-determined stress scenarios that can create extraordinary losses or make the control of risk in the investment strategy difficult? 	
(b) Is the periodic review of the stress test results by senior management documented in the investment governance framework? 	
(c) Do the Board , senior management and relevant Board committees receive reporting on the results of the stress testing in an appropriately detailed report on at least an annual basis?	
(d) Is the Board satisfied that there are appropriate escalation procedures in place to translate potential material issues identified by stress testing into appropriate actions in a timely manner?	
(e) Does the Board receive the documented assumptions in its stress testing program?	
PROCESSES – DEVELOPMENT AND CREATION	YES/NO
(f) Is the RSE licensee able to demonstrate to APRA how the results from its stress testing are taken into consideration when formulating and implementing an investment strategy ?	
(g) Is the RSE licensee's stress testing objective to perform a forward-looking assessment of risk factors?	
(h) Does the RSE licensee's stress testing program include the stress testing methodology employed? 	
(i) Does the RSE licensee' stress testing program also include the following elements:	
i. The roles and responsibilities of persons involved in stress testing?	
ii. The approach to setting and reviewing stress testing assumptions?	
iii. The frequency of stress testing?	
iv. Procedures for reviewing and analysing the results of the stress testing?	
v. Procedures for reporting stress testing results to the Board , senior management, a relevant Board committee and, where necessary, to APRA ?	
vi. Triggers for the escalation of stress testing outcomes?	
vii. Processes for the review of the stress testing methodology?	
viii. Circumstances that might lead to ad hoc stress testing?	
ix. Clarity in relation to the involvement and reliance placed on external service providers in assisting with stress testing?	

PROCESSES – DEVELOPMENT AND CREATION	YES/NO
<p>(j) When developing its stress testing program, has the RSE licensee given due consideration to its investment options and underlying investments?</p> <p><i>⚠️ An RSE licensee may determine that different types of stress testing are appropriate at different levels within an investment option (e.g. individual investments, sector and/or asset class).</i></p>	
<p>(k) If conducting stress testing for investment options with multiple asset classes, does the stress testing program evaluate, at a minimum, how the investment option may:</p> <p>i. Perform under certain circumstances?</p> <p>ii. Meet its investment objectives?</p> <p>iii. Be impacted in its ability to redeem assets during extreme market volatility?</p> <p>iv. Be vulnerable to certain risk factors?</p>	
<p>(l) Does the RSE licensee's documented methodology and process for stress testing align with the RSE licensee's risk management framework? </p>	
<p>(m) If the RSE licensee offers an externally managed investment option, is the RSE licensee satisfied with the extent and quality of the stress testing (processes, procedures and methodology) undertaken?</p> <p><i>⚠️ In addition, APRA expects the RSE licensee to be familiar with, and assess the appropriateness of, the assumptions used in the stress testing.</i></p>	
PROCESSES – OPERATING ASSUMPTIONS	YES/NO
<p>(n) Does the RSE licensee have in place a robust process to determine and document the assumptions in its stress testing program?</p>	
<p>(o) Does the RSE licensee have established parameters within which the assumptions will operate?</p> <p><i>⚠️ A prudent RSE is expected by APRA to consider the appropriateness of the parameters established. APRA also expects a prudent RSE to consider the movement of a specific risk factor when conducting sensitivity analysis, or the movement or co-movement of a combination of risk factors when conducting scenario analysis.</i></p>	
<p>(p) Does the RSE licensee review and validate stress testing assumptions on a regular basis to ensure that they remain relevant and appropriate? This would ideally be conducted annually to coincide with the review of the investment strategy.</p>	
PROCESSES – REVIEW FREQUENCY	YES/NO
<p>(q) Does the RSE undertake stress testing at a frequency commensurate with the nature and risk of the investment option and its underlying investments?</p>	
<p>(r) Does the RSE have predetermined circumstances where ad hoc stress testing would be conducted outside of the regular timeframe?</p> <p><i>⚠️ APRA suggests that a prudent RSE licensee would consider developing triggers to indicate when ad hoc stress testing would be undertaken.</i></p>	

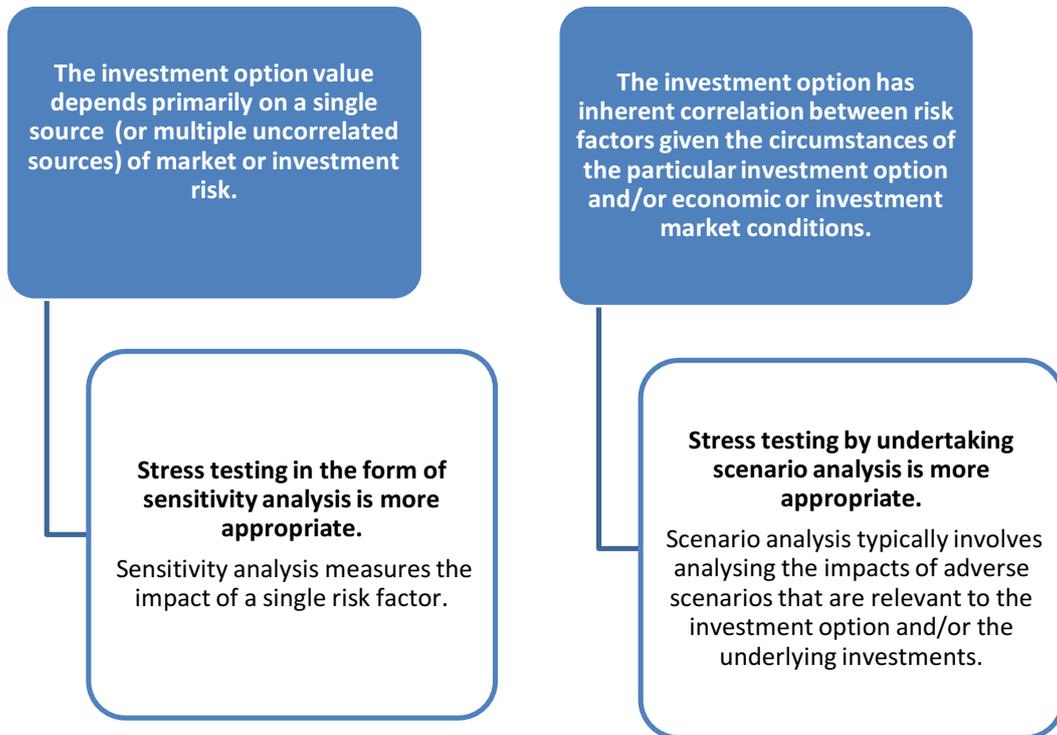
PROCESS – REPORTING	YES/NO
(s) Is the RSE’s stress testing program supported by appropriately detailed reporting to the Board , senior management and relevant Board committees?	
(t) Does the RSE licensee’s stress testing reporting include the following:	
i. The various stress scenarios and risk factors tested, including the coverage of the stress testing?	
ii. The assumptions used when conducting the stress testing?	
iii. The results of the stress testing on the RSE and/or investment options, including whether any tolerance limits were breached?	
iv. Potential actions to be taken as a result of the stress testing results, including any possible changes to investment risk management arrangements?	
v. Analysis of stress testing results against historical results or comparison data to identify emerging trends?	

PROCESSES – REVIEW	YES/NO
(u) Does the RSE licensee’s senior management periodically review the results of the stress tests?	
(v) Does the RSE licensee regularly review the appropriateness of stress tests performed in order to take into account changes in the following:	
i. Market conditions?	
ii. Investment strategy ?	
iii. Liability profile of investment options?	
iv. Circumstances that may affect the liquidity requirements of specific investment options or the RSE as a whole?	

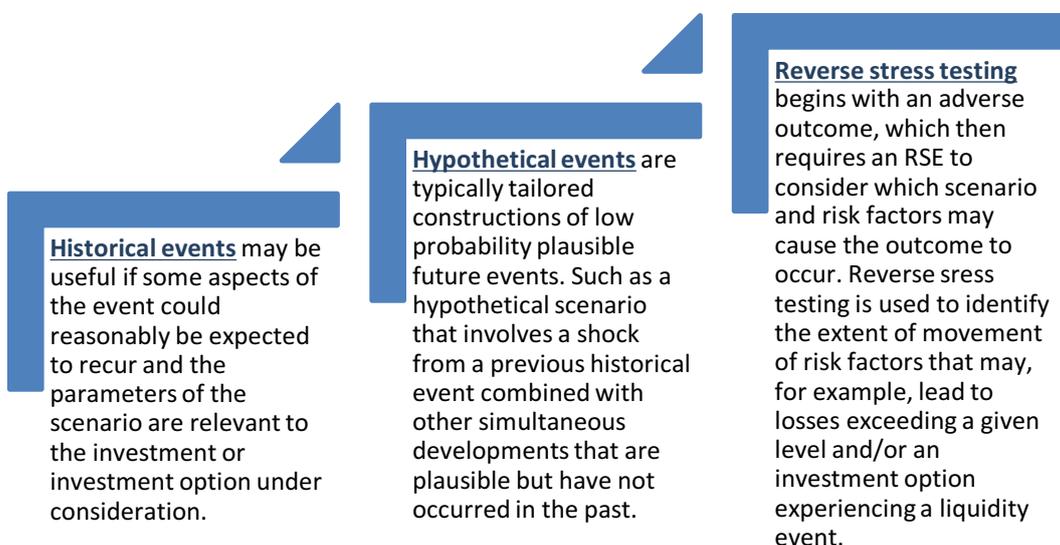
If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

Decision Tree: Stress Scenarios and Risk Factors

Depending on the nature of the investment option, an RSE licensee may determine that either **sensitivity analysis** or **scenario analysis** is more appropriate.



Risk factors in a stress testing program may be determined either by historical or hypothetical events. Reverse stress testing may also be used to identify the extent of risk factor movement.



2.7 Liquidity Management

The following checklist will assist the **Trustee** in assessing whether its **liquidity** management arrangement complies with the minimum requirements in SPS 530 and with the guidance provided in SPG 530.

Liquidity primarily refers to the ability of an **RSE licensee** to meet benefit payments, rollover or transfer requests and intra-fund investment switching requests from beneficiaries in accordance with the SIS Regulations and the governing rules of the **RSE**.

A **liquidity** event may be categorised as beneficiary-generated events (e.g. investment option switching or redemption requests); market-driven events (e.g. significant downturn in equity markets); investment/asset-specific events (e.g. capital drawdowns arising from specific investments or rollover of currency hedge); investment manager-driven events (e.g. an investment option is closed to redemptions); and/or a combination of these events. A liquidity event is any circumstance that the **RSE licensee** considers to be a significantly adverse liquidity outcome that requires action.

BOARD SIGN-OFF	YES/NO
(a) Is the Board satisfied that the liquidity of investments has been appropriately considered when formulating and implementing an investment strategy , while also considering its expected cash flow requirements?	
(b) Is the Board satisfied that within the liquidity management plan (LMP) that there is appropriate reporting on the types of liquidity and cash flow requirements, as well as appropriate triggers for escalation of liquidity matters to the Board ?	
(c) Is there a LMP that covers each investment option within the RSE ? 	
PROCESSES – DEVELOPMENT	YES/NO
(d) Does the RSE licensee understand the sensitivity of the asset allocation of each investment option to any changes in market or member sentiment, which may trigger beneficiaries to exercise their right to change investment options or move to another RSE , leading to the increased need for liquidity ?	
(e) Does the RSE licensee consider the following liquidity -related factors in the formulation of its investment strategy :	
<i>In relation to member demographics and activities:</i>	
i. The age profile of members ?	
ii. Forecasts of inward contributions from members and/or employer sponsors?	
iii. Forecasts of outward benefit payments, taking into account the retention rate and benefit structure (e.g. lump sum or pension payments)?	
iv. Forecasts of member switching activities?	
v. Events likely to trigger a significant number of members switching to another RSE , or switching between investment options?	
<i>In relation to the nature and characteristics of different investments:</i>	
i. The relative ease of saleability of assets?	
ii. Possible market events that may result in previously liquid investments becoming illiquid, and/or a proportionate increase in the holding of illiquid assets as the value of liquid assets fall?	

PROCESSES – DEVELOPMENT

YES/NO

In relation to contractual obligations related to investments:

- i. The cash flow needs for managing a currency hedging program?
- ii. The potential for a cash call by the investment manager for further financing of certain investments?

(f) Does the **RSE** offer an **externally managed** investment option or direct investment option? *If No, proceed to question (h).*

 *The RSE licensee remains responsible for identifying and managing liquidity risk.*

(g) Does the **RSE** formally consider the potential **liquidity** risks and corresponding mitigation strategies when undertaking investment selection?

(h) Does the **RSE licensee** have procedures to measure and manage **liquidity** on an ongoing basis?

 *APRA considers a forward looking approach to **liquidity** management is the best method for an RSE licensee to identify emerging **liquidity** pressures.*

(i) Does the **RSE licensee** have a substantial understanding of the **liquidity** of its investment options?

(j) Is the **RSE licensee** aware of the potential for an investment option to become illiquid in adverse circumstances, as well as how this may affect the value of the investment option and the **RSE licensee's** ability to meet portability and benefit payment obligations?

PROCESSES – FORMULATING A LIQUIDITY MANAGEMENT PLAN (LMP)

YES/NO

(k) Has the **RSE licensee** developed a LMP that covers each investment option within the **RSE**?

 *The LMP should establish procedures for monitoring **liquidity** on an ongoing basis. **APRA** considers the LMP to be a key element in the **RSE licensee's investment risk** management arrangements.*

(l) Does the **RSE licensee** clearly articulate the roles and responsibilities of persons involved in the management of **liquidity** risks both under normal and stressed operating conditions?

(m) Does the **RSE licensee's** LMP articulate the **liquidity** risk tolerances it is willing to tolerate considering the relevant characteristics of the **RSE licensee**?

(n) Does the **RSE licensee's** LMP outline the procedures for measuring and managing **liquidity** on an ongoing basis? 

(o) Does the **RSE licensee** identify the circumstances it considers to be a **liquidity** event? 

PROCESSES – MANAGEMENT OF LIQUIDITY RISK

YES/NO

SPS 530 requires an RSE's LMP to outline the procedures for measuring and managing liquidity on an ongoing basis. The following is a list of what APRA suggests should be included in a LMP.

(p) Does the **RSE licensee** have a sound understanding of its cash flow profile?

(q) Does the **RSE licensee** undertake cash flow analysis on an annual basis, at a minimum?

(r) Is the analysis conducted under both normal and stressed operating conditions at the investment level over various time periods?

(s) Is each of the **RSE licensee's** investment options able to meet its cash flow requirements on a stand-alone basis?

 *That is, the interests of **beneficiaries** would not be compromised by the need to meet cash flow requirements of another investment option within the same **RSE**.*

PROCESSES – MANAGEMENT OF LIQUIDITY RISK	YES/NO
(t) To identify possible short-term to medium-term liquidity needs for the RSE on a forward looking basis, does the RSE use cash flow projections in conjunction with the RSE's cash flow profile?	
(u) Does the RSE licensee regularly review the outcomes of cash flow projections against actual results and review the appropriateness of the assumptions used?	
(v) Has the RSE licensee determined an appropriate buffer of liquid assets within each investment option that could be used to manage liquidity risk?	
(w) Has the RSE licensee developed a set of early warning indicators to identify the emergence of increased liquidity risk or the onset of a potential liquidity event?	
(x) Does the RSE outline what action it will take when a liquidity event occurs?	
(y) Has the action plan been tested to ensure that the actions adequately achieve the intended outcome in managing and/or restoring liquidity within an investment option?	
(z) Has the RSE considered the following things when determining an appropriate action plan:	
i. Assigning responsibilities to personnel for the identification and management of liquidity events?	
ii. Establishing liquidity limits and/or triggers for deteriorating cash flow positions?	
iii. Escalation procedures detailing when and how each of the actions would be taken and nominated timeframes for rectification?	
iv. Identifying key sources of liquidity , their expected reliability and the priority in which assets may be realised to meet liquidity requirements, including an assessment of the impact that selling down assets may have on the intrinsic value of the RSE and the relevant investment options?	
v. How investment-related flows such as contractual arrangements relating to capital calls for investments and margining requirements for derivative holdings would be met?	
vi. Developing processes for meeting beneficiary -related flows such as managing large redemptions?	
vii. Determining responsibilities for communication with relevant stakeholders, including APRA , in the event of a liquidity event?	
PROCESSES – LIQUIDITY MANAGEMENT REPORTING	YES/NO
(aa) Does the RSE licensee document in the LMP the processes for liquidity management reporting?	
(bb) Does the LMP management reporting include the following:	
i. The different types of liquidity or cash flow monitoring reports to be received by the relevant Board committee and/or the Board ?	
ii. The frequency with which various liquidity or cash flow reports are produced?	
iii. Triggers for escalating liquidity matters and breaches to the Board ?	
iv. Procedures for informing staff, beneficiaries, regulators and other stakeholders when a liquidity event occurs?	

PROCESSES – LIQUIDITY STRESS TESTING

YES/NO

- (cc) Does the **RSE** consider how the **liquidity** of investment options can be managed in a range of stress scenarios? 
- (dd) Has the **RSE** developed **liquidity** stress scenarios as part of a comprehensive stress testing program?
- (ee) Are the **RSE licensee’s liquidity** stress test scenarios based on the likely behaviour of future cash flows of assets and liabilities and other contractual commitments under different operating environments?
- (ff) Does the **RSE licensee** consider **RSE**-specific events such as large-scale redundancies within an employer-sponsor, successor fund transfers or market-driven events such as illiquidity of underlying investments as observed during the Global Financial Crisis?
- (gg) When developing **liquidity** stress test scenarios, has the **RSE licensee** considered the marketability of investments within each investment option and the likely value that may be generated from a distressed sale?
- (hh) In respect to the **RSE’s** liabilities and contractual commitments, do the **RSE licensee’s liquidity** stress testing scenarios take into consideration factors such as the potential transactional behaviour of **beneficiaries** under a volatile market scenario?

If the answer is “NO” to any of the questions in the checklist, the RSE licensee should reconsider the issue and address the requirements necessary so as to satisfy itself that it can provide a positive response to the issue. A failure to comply with SPS 530 and the SIS Act requirements may adversely impact an RSE licensee’s MySuper authorisation.

3. Dictionary

AIST means Australian Institute of Superannuation Trustees.

Alpha means the returns derived from skill achieved in excess of explicit and investible benchmarks through selective under or over-weighting of assets.

APRA means Australian Prudential Regulation Authority.

Beneficiary as in s.10 of the SIS Act, in relation to a fund, scheme or trust, means a person (whether described in the governing rules as a member, a depositor or otherwise) who has a beneficial interest in the fund, scheme or trust and includes, in relation to a superannuation fund, a member of the fund despite the express references in this Act to members of such funds. It is used interchangeably in this Toolkit with Members.

Beta means the sensitivity of an investment's return to changes in returns of a relevant market (e.g. ASX 200).

Board means the Board of directors or group of individual Trustees of an RSE licensee and group of individual Trustees has the meaning given in section 10(1) of the SIS Act.

Dynamic Asset Allocation (DAA) means an investment approach that permits asset allocation targets to be changed during the investment period, this is typically in response to changes in specific market factors and/or conditions that change the RSE's investment views in the medium term. Not all RSEs employ this approach but it is the most common. It commonly results in the establishment of a separate portfolio called the DAA, the medium term asset allocation or the target portfolio.

Externally managed means an RSE licensee delegates some of its investment activities to invest on its behalf, generally to capture specialist skill that can't be done by an internal team.

Group means a group comprising of the RSE licensee and all connected entities (as defined in s.10(1) of the SIS Act) and all related bodies corporate (as defined in s.50 the Corporations Act) of the RSE licensee.

Investment objective means the Trustee's desired overall investment outcome for an investment option. APRA expects investment objectives would be measurable, formally documented and clearly communicated.

Investment risk means the risk of an RSE licensee failing to meet its investment objectives due to adverse or inadequate investment performance.

Investment strategy can be broadly described as the RSE licensee's plan for determining the collection of investment options to offer beneficiaries.

Liquidity means the ability of an RSE licensee to meet benefit payments, rollover or transfer requests and intra-fund investment switching requests from beneficiaries in accordance with the requirements of the SIS Regulations and the governing rules of the RSE.

Liquidity provider means an investment option that conducts internal trades with other investment options in the RSE to rebalance these options back to their strategic asset allocation. The liquidity provider investment option then conducts trades with the external market to rebalance its asset allocation.

Member see definition of a beneficiary above.

Registrable superannuation entity (RSE) means:

- (a) a regulated superannuation fund; or
- (b) an approved deposit fund; or
- (c) a pooled superannuation trust;
 - but not a self-managed superannuation fund.

RSE licensee means an entity that holds an RSE licence granted under s.29D of the SIS Act. It is used interchangeably in this Toolkit with **Trustee**.

Scenario analysis means, in regard to stress testing, the analysis of impacts of adverse scenarios that are relevant to the investment option and/or the underlying investments. Adverse scenarios typically comprise a range of risk factors that are simultaneously varied. This type of analysis reflects the inherent correlation between risk factors, given the circumstances of a particular investment option and/or economic or investment market conditions.

Sensitivity analysis means, in regard to stress testing, the measurement of the impact of a single risk factor. This is typically considered to be appropriate where the investment option value depends primarily on a single source (or multiple uncorrelated sources) of market or investment risk.

SIS Act means the *Superannuation Industry (Supervision) Act 1993*. Provisions relevant to Prudential Standard SPS 530 and this Toolkit include but are not limited to sections 52 and 29VD.

Strategic Asset Allocation (SAA) means the long-term asset allocation (and ranges) targeted under normal or equilibrium market circumstances. As a result, it tends not to change frequently but rather only in response to significant expected changes in the environment or within the RSE. Other terminology used for the SAA includes the long-term SAA (LTSAA), the neutral asset allocation and the asset allocation benchmark. This is in contrast to the **Dynamic Asset Allocation (DAA)** defined above.

Tactical Asset Allocations (TAA) means very short-term deviations in the asset allocation to try to capture short-term tactical opportunities presented in the market. This approach requires very active management and is less common within Australian RSEs.

Trustee, in relation to a fund, scheme or trust, means:

- (a) if there is a trustee (within the ordinary meaning of that expression) of the fund, scheme or trust – the trustee; or
- (b) in any other case – the person who manages the fund, scheme or trust.

Prepared by:



AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES

Ground Floor, 215 Spring Street, Melbourne VIC 3000

www.aist.asn.au



FRONTIER ADVISORS

Level 16, 222 Exhibition Street, Melbourne VIC 3000

www.frontieradvisors.com.au

With the assistance of:



super@millsOakley.com.au

www.millsOakley.com.au



AUSTRALIAN MADE



RECYCLED CONTENT



FOREST MANAGEMENT



CERTIFIED
CO₂
NEUTRAL