

SUBMISSION

Submission to Treasury
on the *Your Future, Your
Super Regulations and
associated measures*

25 May 2021

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Director
Retirement Income Policy Division
Treasury
Langton Cres
Parkes ACT 2600

Via email: superannuation@treasury.gov.au

25 May 2021

Dear Sir/Madam,

‘Your Future, Your Super’ exposure draft regulations and associated measures

The Association of Superannuation Funds of Australia (ASFA) is writing in response to your consultation on the ‘Your Future, Your Super’ exposure draft regulations released for feedback and comment on 28 April 2021.

About ASFA

ASFA is a nonprofit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 16 million Australians with superannuation.

GENERAL COMMENTS

ASFA supports the objective of ensuring the good governance of superannuation funds and addressing product underperformance.

It is important, however, that this is done in the right way.

ASFA has some concerns about the appropriateness of some of the provisions of the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* (the Bill), which have been detailed in submission made to Treasury on the exposure draft of the Bill and in a submission to the Senate Economics (Legislation) Committee on the Bill as introduced into Parliament. These are addressed in the General Comments section of the submission.

SPECIFIC COMMENTS

ASFA member organisations have raised some issues about aspects of the ‘Your Future, Your Super’ exposure draft regulations which are the subject of this consultation (Exposure Draft regulations). These are outlined in the Specific Comments section of the submission.

Should you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4021 or via email to fgalbraith@superannuation.asn.au.

Yours sincerely



Fiona Galbraith
Director, Policy

[The Association of Superannuation Funds of Australia Limited](http://www.superannuation.asn.au)

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A. General comments on the proposed Your Future, Your Super regime

1. Australian superannuation funds' investment performance

Australian superannuation funds consistently have achieved strong investment performance when assessed on the basis of outcomes delivered to members, both on an absolute basis and when compared with other pension funds internationally. By way of example, the OECD in its report *Pensions at a Glance, 2019 OECD and G20 indicators*, observed that over the last 15 years Australia has the second highest average annual return of OECD pension funds.¹

Accordingly, we are concerned about the suggestion that 25 products, 4 million accounts and \$129 billion in funds under management (FUM) could be identified as 'underperforming' – this would appear to be a material overstatement of the number of underperforming products by any reasonable, objective measure.

2. Commencement date

The proposed commencement date is 1 July 2021.

Given the complexities involved with respect to the Single Default Account measures in particular, and the potential impact on employers, together with the number of issues identified with the Exposure Draft regulations, this does not provide sufficient time to implement the measures.

Recommendation 1

The commencement date of the Bill should be 1 July 2022.

3. Performance benchmark test – retrospective application

The performance benchmark test has retrospective application.

This means that products will be measured and assessed against legislative criteria that were not in place during the period over which the product is being assessed.

This led to the Scrutiny of Bills Committee requesting detailed advice as to:

whether the proposed scheme for annual performance assessments may have a retrospective application and, if so, whether any persons are likely to be adversely affected and the extent to which their interests are likely to be affected².

Eight years after the commencement of MySuper products their outcomes are now to be evaluated on investment performance assessed retrospectively against a new set of benchmarks that had not been prescribed at the outset.

4. Performance benchmark test – in conflict with best interests & member outcomes

The common law fiduciary duty is for trustees to act in the best interests of members.

Consideration of 'member outcomes' generally aligns with the trustee's duty to act in the best interests of members – especially when it comes to making investment decisions over the medium to long term.

In managing MySuper products the super industry has set 'CPI plus' investment targets, as recommended by the Cooper review and APRA, disclosed these investment targets in MySuper product dashboards, complied with guidance from APRA as to member outcomes and had regard to the two years of MySuper heatmaps.

¹ OECD, *Pensions at a Glance 2019, OECD and G20 indicators*, Page 214

² *The Senate Standing Committee for the Scrutiny of Bills, Scrutiny Digest 4 of 2021, para 1.38*

The question has been raised as to whether the benchmarking approach potentially is in conflict with members' best interests and member outcomes, as it measures the returns of assets in a particular class against the index for that class, a measure of investment efficiency, but does not take into consideration the strategic asset allocation or risk of the investment portfolio underlying the product. The best measure of whether an investment is in members' best interests and produces good outcomes for members is the long-term risk-adjusted investment performance.

ASFA therefore recommends that the performance test not rely on a single metric. This is discussed further under 8. *Performance benchmark test – need for a two stage assessment mechanism* below.

5. Performance benchmark test – effect on investment decisions

ASFA has serious concerns that the proposed performance test will have unintended consequences in that it will drive investment decision-making that will be contrary to the objective of delivering good member outcomes over the medium to long term.

Given the seriousness of the consequences of the 'performance' test, the proposed test will drive trustees to make investment decisions effectively to 'hug the index', in conflict with the objective of delivering good member outcomes.

ASFA wrote to the Treasurer on 24 November 2020 about the industry's concerns that the performance test, with its benchmarking methodology, would have unintended consequences for the way in which super savings are invested. The letter was signed by the Chief Investment Officers of eight major super funds and five large investment managers and a copy can be found in the Annexure to this submission.

Recent research performed by the Conexus Institute into the opportunity cost of the performance test proposed under the Bill has revealed that, should funds invest to prioritise passing the performance test, consumers will incur an opportunity cost of \$3.3b per annum.³

6. Performance benchmark test – recommend initial trial run period

Given the concerns about the potential effects of the proposed performance test, the significance of the consequences of failure and the risk of unintended consequences in the outworking of the test, ASFA submits that consideration should be given to there being a 'trial run' for a two year period.

During the 'trial-run' period the test would still apply but the consequences for a product that did not meet the benchmark would not be triggered, instead, a trustee effectively would be 'put on notice' as to the product's performance. This would provide the opportunity for an orderly transition through a mechanism such as a successor fund transfer, which would be in the best interests of fund members.

This would also allow the performance test to be refined if necessary – the very fact that the performance benchmark test is prescribed in the regulations, as opposed to being in the Bill, speaks to a need for flexibility to refine the test over time.

This would also have the added benefit of allowing performance to be measured over a ten year period, which would be a more appropriate period than the current eight year period prescribed in the regulations.

Recommendation 2

There should be a 'trial run' of the performance benchmark test for a two year period.

Recommendation 3

The lookback period should be ten years, not eight years.

³ *Your Future Your Super Performance Test, Estimating the Opportunity Cost to Consumers, 10 March 2021, Author: David Bell, Page 3*

7. Performance benchmark test – not a ‘reviewable decision’

Notwithstanding that the performance benchmark test has been designed to be a ‘bright line test’, it is inappropriate that APRA’s determination of the results of the test will not be a ‘reviewable decision’.

Amongst other things, given the complexity involved in the reporting of data and the changes to the data reporting standards over the years, there may be an issue with the data underlying the assessment.

APRA’s determination of the results of the annual performance test must be a ‘reviewable decision’.

8. Performance benchmark test – need for a two stage assessment mechanism

It is imperative that superannuation products are not assessed solely on the basis of the performance benchmark test.

ASFA submits that there should be a two-stage approach to assessing performance. Should a product not meet the legislative performance test, the second stage would be a ‘balanced scorecard’ assessment, whereby APRA would evaluate whether the product has been, or is likely to, deliver appropriate member outcomes and whether its ‘underperformance’ has been, or is likely to be, rectified in the short term.

There is a need for there to be qualitative oversight and consideration of matters such as the effect of investment cycles and exogenous events, exercising judgement and expertise.

Potential examples of criteria that could be incorporated into a ‘balanced scorecard’ assessment include:

- *recent short-term net investment performance*
 - a product may have had poor performance in the early part of the assessment period, which dragged down its longer term average, but recent performance could be strong
 - poor performance is attributable to investment cycles or an exogenous event, such as the disruption to investment markets or the value of certain assets caused by the pandemic
- *recent reduction in fees charged directly to members* – the trustee may have reduced fees charged directly to members in recent times, which will improve member outcomes going forward
- *changes in structure or business operating model* – there may have been a material change in the structure of the fund, or its business operating model, which will improve investment performance and/or member outcomes in future
- *improvements in investment governance processes* – the trustee may have effected changes to its investment management framework that improved the investment performance of the product, and this is likely to continue
- *improvements in broader governance and risk or compliance management* – a trustee may have experienced governance, risk or compliance issues but has taken action, such as replacing directors and/or key risk or compliance personnel; implementing material improvements to its governance framework; or overhauling or enhancing its risk management and compliance framework
- *quality and value of insurance* – regard could be had to the quality and value of the product’s insurance offering, including cover tailored to its members and the payout to premium ratio
- *provision of, and investment in, member services, including advice* – this could help account for products that have higher fees but in return provide a higher level or quality of services and benefits, such as financial advice or IT applications, which are appropriate for their members, or where the trustee has invested additional expenditure in product or service innovation.

Recommendation 4

There should be a two stage approach to assessing performance.

Should a product not meet the legislative performance benchmark test, the second stage would be a 'balanced scorecard' assessment, whereby APRA would evaluate whether the product is delivering appropriate member outcomes and whether the 'underperformance' has been, or will be, rectified.

9. Performance benchmark test – use of historical data not previously used for this purpose

Member organisations have expressed concerns about the integrity of the data used for the performance assessment as the calculations will rely on historical data which was not used for this purpose previously and believe there may be a need for APRA and the trustees to validate the data and, in some instances, for trustees to re-report it.

It has been raised that reporting of data has not always been consistent between funds, for example, historically there have been differences in how administration fees and insurance premiums have been categorised and reported. Member organisations have also raised that the reporting to APRA may not always have been accurate or complete, which would affect adversely the quality and reliability of the data upon which the performance test will be based.

10. Performance benchmark test – trustee to notify members of fail assessment

Subsection 60E(5) of the Bill requires that the notice must consist of a letter sent to the member by pre paid post or by courier, as well as an electronic communication sent to the member.

Member organisations have expressed concern that the cost of sending a letter by post to every member will be significant, and is not in line with the current regulatory positions supporting electronic communication. If there is a nominated electronic address for the member it would be reasonable to proceed on the basis that the member would expect the fund to communicate with them electronically.

We note also that, while the Bill provides for when there is no nominated electronic address, it does not provide for when there is no valid, current address of the place of residence or business of the member, or where there has been returned mail. In fact the Bill appears to require the trustee send a notice to the address of the place of residence or business of the member last known to the trustee, presumably even in circumstances where the trustee has received return mail and knows the address no longer to be a valid, current address.

11. Need for CGT rollover relief – intra-fund mergers, structural rationalisations and reorganisations

One of the outcomes of the performance assessment test is likely to be an increase in the need for fund mergers, structural rationalisations and reorganisations to take place.

The passage of legislation in May 2020 to make permanent the capital gains tax (CGT) roll-over relief for merging funds provided welcome certainty to the industry and was an important step toward ensuring tax outcomes do not act as a barrier to fund consolidation. The industry was also appreciative of amendments, legislated in December 2020, to ensure certain member elections remain valid following a fund merger, and to allow the transferee fund to receive a refund of no-TFN contributions tax paid by the transferor fund prior to a merger.

In order to provide effective and practical relief to merging products there is a need to extend the CGT roll-over relief to include circumstances involving the transfer of groups of members and their assets from one superannuation fund to another without the closure of the original fund — for example, where member divisions or subplans within one large fund are moved to another large fund. As superannuation funds grow and mature, they need to have the ability to restructure investment holdings so their structures remain efficient and fit for purpose.

Extension of the CGT relief would allow for the rationalisation of structures following a merger, which is outside the scope of the current CGT relief, and in response to the organic growth of funds. As the industry continues to mature there will be a range of ways in which funds may seek to rationalise their operating structures to achieve greater efficiency and reduce costs to members.

We consider it appropriate that the relief available to superannuation funds seeking to rationalise their operating structures should be as broad as those available to corporations, which has been a feature of the CGT regime since the outset.

ASFA is concerned that without further expansion of the CGT relief, superannuation funds will continue to be subject to restrictions that appear contrary to the policy intent and principles of the CGT rollover provisions. Effective rollover relief would avoid circumstances where assets effectively are ‘locked-in’ to inefficient business structures, provide cost reduction benefits to members and produce an efficiency gain for the wider economy.

Recommendation 5

CGT rollover relief should be extended to include the transfer of members and assets from one fund to another without the closure of the original fund.

B. Specific comments on the Exposure Draft regulations

1. Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021

1.1 Annual performance assessments

Member organisations have welcomed the addition of two new indices to improve the benchmarking process and generally are supportive of the inclusion of the administration fee in the assessment.

They have raised the following issues with the Exposure Draft regulations.

1.1.1 International Unlisted Property Index

Member organisations have observed that the International Unlisted Property Index used is more focussed on Australian property, which puts funds who invest more in international property at a disadvantage.

Accordingly, ASFA recommends that consideration be given to an index which is more balanced across both Australian and international markets.

1.1.2 Administration fees

Member organisations have expressed concerns that the use of the median administration fee as the yardstick for ‘failure’ is unduly harsh, significantly more so than the investment performance benchmark, and translates to half of the funds at any point in time being considered to have ‘failed’ with respect to administration fees.

Further to this, member organisations have identified that, given the complexity involved in the reporting of data and the changes to the data reporting standards over the years, data may not always be reported on a consistent basis and may not be readily comparable.

1.1.3 Schedule 2A — information in notice under subsection 60E(2) of Act

A number of members have expressed concern that the wording of the letter to be sent to members when a product has not met the annual performance assessment is overly prescriptive, right down to the salutation, has the potential to cause significant alarm and distress among members who receive it and in some circumstances potentially may be misleading.

In particular, the performance assessment is retrospective but this may not be representative of the member’s current or prospective experience and the wording in the letter does not reflect this.

ASFA recommends that, in lieu of a requirement to send a ‘pro-forma’ letter, there should be a ‘principles based’ prescription of the content of the notice and flexibility should be provided to allow the actual wording of the notice to be tailored as appropriate. This would be accompanied with a requirement to include ‘specified key messages’ in the notice, together with an overarching obligation for the notice not to be misleading or deceptive.

1.1.4 Schedule 2A – specified key messages in notice to members

ASIC guidance for promotions / advertising to retail clients with respect to investment performance is that it requires a warning to the effect of ‘past performance is not a reliable indicator of future performance – this should be one of the ‘specified key messages’ to be included in the notice to members.

In addition, the ATO approved rollover/transfer request form contains warnings about the potential loss of benefits, in particular insured benefits, and that there may be some costs involved, including CGT and buy/sell spreads, that ideally should be specified as key messages as well.

Ideally the notice should be allowed to

- indicate YourSuper is a tool the member may wish to use, as opposed to directing them to use it
- make it clear that the product has underperformed a benchmark set by the government
- refer to a broader range of relevant factors a member could consider when determining whether a product will meet their retirement goals

- with respect to lifecycle products – clarify that one or more of the lifestages has underperformed, affecting the performance of the product overall, but the performance for the overall product may not reflect the performance experienced by the member in their particular lifestage.

2. Treasury Laws Amendment (Your Future, Your Super—Improving Accountability and Member Outcomes) Regulations 2021

2.1 Portfolio Holdings Disclosure

We are committed to greater transparency for superannuation fund members.

Member organisations have indicated, however, that in some instances the requirements with respect to portfolio holdings disclosure not only will be of limited value to members but may be counterproductive.

Our member organisations have raised some concerns with respect to the proposed portfolio holdings disclosure regulations, which they consider are not in the best interest of members and may adversely affect investment outcomes for members, as follows.

2.1.1 Disclosure of commercially sensitive information / breaching of confidentiality

A number of member organisations have expressed concern that aspects of the portfolio holdings disclosure regime will force trustees to disclose commercially sensitive positioning and investment strategies, that may undermine future investment returns.

Importantly, disclosure of certain information is likely to breach the confidentiality provisions of agreements with service providers / investment managers, in particular information with respect to derivatives counterparties and certain identifiers.

2.1.2 Fixed income securities — individual face value and coupon values

Member organisations have raised concerns that having to disclose the individual face value and coupon values of fixed income securities may cause them to breach confidentiality obligations with issuers.

2.1.3 Ability to aggregate certain issuers – e.g. term deposits

Member organisations have recommended that, with respect to certain investments such as term deposits, they should be able to aggregate by issuer as opposed to disclosing each and every term deposit.

2.1.4 Private equity holdings

We recommend that, where funds are disclosing a holding in private equity, they should be required to indicate a range of values but not be required to disclose a precise value.

If disclosure were to be required then, as some private equity funds do not permit entities to invest if they will disclose their investment, this will exclude trustees from opportunities to invest in private equity.

2.1.5 Disclosure of holding price of unlisted assets

Member organisations have expressed concern about being required to disclose the price of their unlisted assets to the market which, should they wish to sell them, would work against maximising the return on that asset, which clearly is not in the best interests of members.

Further, disclosure of a specific price may increase the difficulty of procuring valuations for unlisted assets – for a number of reasons valuations generally are performed on the basis that they are confidential.

ASFA recommends that the disclosure of a holding price of unlisted assets either should be on a ‘bundled’ basis or should be a range.

2.1.6 Derivatives and hedging contracts – counterparty and price information

A number of member organisations have expressed concern with respect to the level of granularity of the proposed disclosures with respect to derivatives and hedging positions.

Portfolio holdings disclosure should not be required in a way that adversely affects commercial considerations or which discloses ‘commercial in confidence’ or commercially sensitive information.

In particular, counterparty information is proprietary in nature and irrelevant to consumers and should not be required to be disclosed publicly.

Members have also queried the benefit to members of providing the price of futures contracts.

By way of example, in the case of foreign exchange (FX) forwards or options, funds will need to disclose the contract price and the counterparty. Disclosure of this information may undermine the position of the fund as often these contracts are rolled forward or rebalanced via liquidity providers.

Member organisations have raised three major concerns with respect to this:

- *confidentiality* – the super fund may be disclosing information which will breach its obligations to the counterparty in these contracts, including a duty of confidentiality
- *market impact* – the aggregate size of outstanding hedges has the potential for significant market impact. Disclosure of the amount risks alerting the market to the size and direction of exposures that may affect pricing and liquidity and ultimately disadvantage super funds, especially with respect to less liquid derivatives
- *inconsistency with other jurisdictions* – the portfolio holdings disclosure requirements are not consistent with other jurisdictions such as the UK, where exposures are reported only in aggregate and not on a ‘case by case’ / ‘name by name’ basis.

One possible solution, which supports transparency but also serves to protect the commercial aspects of FX contracts and the confidentiality of counterparties, would be to disclose as per the following table.

| Forwards: As proposed in the ED regs | Forwards: A possible alternative approach |
|---|--|
| Name / Kind of investment item | Name / Kind of investment item |
| Bought / Sold position | Bought / Sold position |
| Amount | |
| Price in Contract (underlying) | |
| Notional Amount | |
| Maturity Date | |
| Currency of Contract | Currency of Contract (G10) |
| | Currency of Contract (Other) |
| Counterparty | |
| Counterparty Credit Rating | Range of Counterparty Credit Ratings |
| Value (AUD) | Notional Value of Forwards (AUD) |
| Weighting | Weighting |

Another possibility may be to adopt an approach where derivatives of the same kind could be aggregated. Within any particular investment option there may be hundreds, or even thousands, of derivatives, the disclosure of which would extend over multiple pages/screens and be of little benefit to members.

2.2 Annual Member Meetings

2.2.1 Need for guidance as to ‘marketing expenses/payments’ & ‘third party payments’

Member organisation have identified that greater guidance is needed as to the definitions of ‘marketing expenses/payments’ and ‘third party payments’:

- marketing expenses – members have identified that there is a need for greater clarity as to what should be included as a marketing expense. By way of example, does it include the salaries paid to marketing staff and the cost of internal information technology and communications equipment
- related third party payments – members have observed that related third party payments should align to existing disclosures in financial statements, but currently they appear not to do so.

2.2.2 Itemised list showing each payment

Including an itemised list showing each payment made by, or on behalf of, the fund during the income year will not provide significant value to members and is overly onerous, causing additional administration costs.

We recommend that the regulations should be amended to allow for a level of aggregation in the payments reported to members in itemised lists.

2.3 Employer inducements

Some member organisations have indicated that they have relied on the revoked section to provide education programs to members through employers and they are concerned that there may be unintended consequences with respect to this.

3. Treasury Laws Amendment (Your Future, Your Super—Single Default Account) Regulations 2021

3.1 Single Default Account

3.1.1 Need for trustee relief and guidance with respect to employer errors in contributing

Member organisations have identified that relief and guidance is provided for employers who make errors with respect to making contributions, however, there is no guidance given to funds with respect to how to manage contributions that have been received in error. Trustees require greater certainty as to how to manage those contributions in order to avoid compounding the effect on members of any errors made by employers.



24 November 2020

The Hon Josh Frydenberg MP
Treasurer
By e-mail

Copies to:
Senator Jane Hume – Assistant Minister for Superannuation, Financial Services and Financial Technology
Ms Helen Rowell - APRA Deputy Chair
Dr Steven Kennedy - Treasury Secretary

Dear Treasurer

Re: Your Future, Your Super – Investment Issues

We are writing to you in relation to the Government's 'Your Future, Your Super' package announced in the Federal Budget.

We commend the objective of the package to maximise the retirement savings of all Australians, so that they can enjoy a higher standard of living in retirement. This objective also is at the heart of every investment decision we make on behalf of fund members and highlights our common purpose.

We are concerned that the benchmarking methodology and underperformance test will have unintended consequences for the way in which superannuation savings are invested that are contrary to delivering good member outcomes. The key issues are:

- a. The benchmarking framework is too simplistic to capture the diversity of strategic asset allocations that are fundamental to building long-term wealth for fund members.
- b. For unlisted assets, implementation of the proposed benchmark indices will lead to a lower level, and different mix, of investment than is optimal for long-term returns. This will also have broader implications for the Australian economy.
- c. In particular, implementation of the proposed benchmark indices may lead funds to shift their investments to the types of assets that are contained in the indices:
 - i. The infrastructure index is comprised mainly of North American infrastructure assets (80% of the total), with a concentration in railways and electricity generation. A shift towards this allocation is likely to lead to lower levels of domestic infrastructure investment by funds
 - ii. The property index is dominated by a small number of property developers, who have a fundamentally different risk profile than owners of property assets. Implementation of this index is likely to lead to lower investment in real commercial property assets.
- d. The benchmarks do not provide scope for funds to invest more defensively within asset classes, so strategies designed to reduce or manage market risks could be unintentionally compromised. Defensively orientated portfolios including those

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designed for retirees, will be required to increase risk or exit the market, increasing risk within the system.

- e. International best practice is that targeted risk-adjusted return objectives are a more appropriate way of measuring performance (for example CPI+), and the Government's Future Fund is a prime example of this. Superannuation funds are required to set and disclose CPI+ return targets for MySuper products to members.
- f. Implementation of new benchmarking methodology should recognise that investment strategies have been set to achieve Member Outcomes tests that prescribe a different approach to performance measurement.
- g. The proposed benchmarking is inconsistent with consumer disclosures that past performance is not an indicator of future performance.

We believe that our combined insights and experience can be of practical use to Government in developing these important reforms.

We would appreciate the opportunity to have an open and constructive dialogue with you on these matters, prior to the legislation being introduced into Parliament.

We look forward to meeting with you as soon as is practicable to discuss these critical issues.

Yours sincerely

John Pearce
Chief Investment Officer
UniSuper

Sonya Sawtell-Rickson
Chief Investment Officer
HESTA

Damian Graham
Chief Investment Officer
Aware Super

Sam Sicilia
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Aberdeen Standard Investments

Rachel Farrell
Chief Executive Officer
JP Morgan Asset Management

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