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**Submission: Your Future, Your Super Regulations – Addressing Underperformance in Superannuation Exposure Draft.**

Credi Consulting is a boutique consultancy firm. We attach submissions for your consideration.

Yours faithfully

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## A. Introduction and summary

1. As currently drafted, the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (Bill)* and the *Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021* exposure draft (**Regulations**) create a potential anomaly where fundamental changes to trustees' investment processes are discouraged whereas the creation of new products and mergers (with no requirements as to scale) are encouraged by the application of the performance test.
2. This outcome may have the potential to drive behaviour that is inefficient, such as the creation of new products where existing products could be fundamentally modified to improve performance.
3. Current funds of significant scale are most likely to be unable to effect mergers due to their significant size and the lack of appropriate receiver funds. There should be a mechanism whereby these funds can materially reform their investment strategy rather than being subject to a mechanism designed to create fund outflows while incentivising funds to seek outperformance.
4. Giving APRA a discretion to assess material changes to funds as being of a type that renders past performance not indicative of future performance would limit inefficiency with its associated cost and disruption to members while protecting the interest of members, particularly those that are disengaged from their superannuation investment and thus unlikely to benefit from the performance test.

## B. Current state of APRA discretions

5. In accordance with the Bill and the Regulations APRA holds two key discretions relating to potential restructuring of superannuation funds:
  - (a) its discretion under s.60G of the Bill and its associated regulations at 9AB.4 and 9AB.5 of the Regulations whereby APRA can determine that multiple Part 6A products be treated as one Part 6A product (**Merger Discretion**); and
  - (b) its discretion under Regulation 9AB.9 of the Regulations whereby APRA can determine that a Part 6A product be made subject to performance testing despite the lookback period for that product being less than five years (**New Product Discretion**).
6. The Merger Discretion is virtually unconfined, with the only requirement being that APRA consider the exercise of its power "appropriate in the circumstances", while the New Product Discretion requires that APRA consider whether an entity, or an associated entity, which offers a new product has other products which have failed performance testing.
7. The Explanatory Memoranda to both the Bill and the Regulations make it clear that the purpose of both discretions is anti-avoidance. By the operation of the discretions APRA can make products subject to performance testing where:
  - (a) underperforming products are merged into other products, operated by either the same or a different entity; and/or



(b) new products are created to replace underperforming products.

### **C. Operation of the APRA discretions**

8. In determining whether to exercise its discretion, APRA will need to make quantitative and qualitative assessments to determine whether a new merged product, or a new product, has features which mean the past performance of a defunct product should be attributed. Such a determination will inevitably require APRA to assess whether a merged or new product simply constitutes a “rebadging” of an underperforming product, or whether the merged or new product has characteristics which mean that the merged or new product should be assessed independently of any defunct product.
9. The existence and operation of the APRA discretions in the above way raises the question as to why APRA’s discretion is limited to the case of merger and new products, and does not extend to circumstances where products undergo fundamental changes so as to make past performance irrelevant to potential future performance.

### **D. Change in investment process**

10. A key area where a product can have a fundamental change is in relation to the processes which are adopted by a trustee for investment.
11. Although structures vary, responsibility for investment of members’ funds rests ultimately with a fund’s trustee board. The way in which that trustee board complies with its duties to members and directs the investment of members’ funds is fundamental to performance.
12. Trustee boards have ultimate responsibility for strategic asset allocations, investment strategy for asset classes and investment options, and specifying investment return and risk objectives, however, these decisions are ultimately made on advice and depend upon recommendations. Recommendations flow from investment teams to investment committees and ultimately to the board (**Investment Structure**).
13. The current products in the superannuation market have varied approaches to their Investment Structure, including:
  - (a) delegation from Trustee boards to investment committees;
  - (b) reliance on asset consultants;
  - (c) having large in-house investment teams; and
  - (d) outsourcing a large part of investment to third parties.
14. It is posited that, given the centrality of a products Investment Structure, in exercising either the Merger Discretion or the New Product Discretion, APRA will need to give consideration as to whether the Investment Structure within a product is the same as a previously underperforming product or whether the new or merged product is simply the continuation of a previously underperforming Investment Structure operated by previously underperforming individuals and entities.



15. This raises the question – why is there no APRA discretion so as to allow a determination that a change to Investment Structure is so material so as to make past performance calculated per the Regulations irrelevant?

**E. Potential discretion**

16. The legislative aim of both the Bill and the Regulations is member protection rather than a punitive measure against entities offering previously underperforming products. This aim can be achieved by specifying certain material changes to an Investment Structure for a product which trigger an assessment by APRA as to:
  - (a) whether the change is such that past performance as calculated by the Regulations is no longer related to future performance in a meaningful way; and
  - (b) what performance testing should now apply given the change.
17. It is suggested that the following situations would constitute such a material change to Investment Structure:
  - (a) a trustee switching from an internal Investment Structure (including outsourcing to related entities) model to a fully outsourced model with an independent third party;
  - (b) a trustee switching from a fully outsourced model with an independent third party to an internal Investment Structure model; and
18. Where a material change occurs, there would appear to be no difference in that case from the assessment required by APRA in determining whether to exercise its New Product Discretion in combination with its Merger Discretion.