

Your Future, Your Super Regulations and associated measures

Submission

25 May 2021

David Bell

About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, The Institute is supported by the insights of a high-quality advisory board, whereby each member's involvement is on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Research is generally made open source to create transparency and accountability. All research on the Your Future, Your Super reforms has been made open source. The Conexus Institute exists with no commercial relationships. Further information [here](#).

About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and last year completed his PhD at UNSW which focused on retirement investment problems. Full bio [here](#).

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1. Summary

Overall, we celebrate the positive intent of the reforms in Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (and associated regulations). In particular, the intent to remove unintended multiple accounts, create greater accountability for investment performance, improve transparency, and encourage engagement are noteworthy.

Our recent research efforts have focused primarily on further analysing the stapling model and the performance test.

The YFYS stapling model (single account) and the alternative employment-based stapling model have competing positive and negative impacts. By the time we account for the costs of account switching and the likelihood of (and need for) a review of insurance in super, we believe the YFYS account-based stapling model is appropriate. The most important thing is that stapling proceeds and that the major source of multiple account creation is removed.

The YFYS performance test is effectively a 'past sins' test. The YFYS performance test will provide limited insights into forward-looking relative performance. We believe APRA's current approach, assuming strong implementation, would deliver superior consumer outcomes to a 'bright-lines' YFYS performance test. In our view the creation of a 'bright-lines' performance test will dilute the effectiveness of APRA's approach with a negative relative impact on forward-looking consumer outcomes.

A bright-lines test places aside too much important information, notably through-time changes made to governance, investment capability and investment strategy. Accordingly, analysis of the test needs to focus on two areas:

1. Ensuring the YFYS performance test is a quality assessment of past performance to ensure fairness and acceptance (placing aside the question of whether a 'past sins' test applied retrospectively is fair).
2. Ensuring the YFYS performance test does not distort ongoing decisions of trustees away from investing for member best outcomes.

In our view (1) remains an issue while (2) is greatly improved following recent changes (additional indices). (1) can be simply improved through the addition of a second metric based on risk-adjusted returns.

The success of the reforms and the management of the sizable unintended risks they create will heighten the importance of a strong performing APRA. We suggest policymakers and regulators maintain a watch on whether the creation of a national consolidation fund would accelerate consolidation and protect heavily disengaged consumers.

2. Acknowledgement

A working group of investment researchers collaborated to explore the YFYS performance test. The work in this submission which relates to the YFYS performance test has been largely taken from work released by The Conexus Institute and reviewed by the working group (all research is available [here](#)). However, the author takes full ownership and responsibility for all material presented in this submission.

The author would like to recognise members of the working group: Nick Callil and Tim Unger from Willis Towers Watson, Andrew Boal from Rice Warner, Emily Barlow and Clayton Sills from Mercer, Matthew Griffith from JANA, and David Carruthers and Kim Bowater from Frontier.

3. Addressing the changes in the YFYS Regulations and associated measures

This section addresses the changes incorporated into the regulations. The most significant changes are:

1. Additional indices for unlisted property and infrastructure.
2. The inclusion of administration fees into the YFYS performance test.

3.1. Impact of additional indices for unlisted property and infrastructure

The inclusion of additional indices for unlisted property and infrastructure improves the quality of the YFYS performance test by reducing benchmarking noise (variation between the portfolio assets and the benchmarks used to assess performance). In our previous analysis these two sectors were the largest source of benchmarking noise.

The additional indices will always be an imperfect reflection of the investment activities of super funds in these sectors, but they are reasonable given the dearth of representative benchmarks for these sectors.

We previously undertook two major research pieces on the YFYS performance test:

1. We assessed the statistical effectiveness of the performance test (see Section 4.2.2. of our [Senate submission](#) for an overview).
2. We assessed the degree to which the performance test would constrain super funds from designing and implementing investment strategies in the best interests of members (see Section 4.2.3. of our [Senate submission](#) for an overview).

Updates to these two research pieces, incorporating the additional indices, are included in Appendix 1 and Appendix 2.

We found that the effectiveness of the performance test remains dependent on what is driving performance:

- The YFYS performance test will now be more effective at identifying underperforming (outperforming) funds when the underperformance (outperformance) is attributable to implementation.
- The YFYS performance test will remain highly ineffective at identifying underperforming (outperforming) funds when the underperformance (outperformance) is attributable to strategic asset allocation.

We find that the degree to which the YFYS performance test inhibits investment strategy, previously found to be significant (to the extent that the estimated opportunity cost of the constraints, \$3.3b pa, was more than the benefits of the entire YFYS reform package), is now significantly reduced (\$0.4b pa). By our assessment most 'good' funds will not have to significantly alter their investment strategy to maintain an appropriately small likelihood of failing the test. Some caveats remain, particularly for funds which allocate to alternatives assets.

3.2. Impact of incorporating administration fees

The incorporation of administration fees changes the test from an assessment of investment performance to a measure of consumer outcomes. As written previously (section 4.2.7 of our [Senate submission](#)) the question of whether to include administration fees in a performance test is quite nuanced; overall we are supportive.

It is important to consider the most appropriate basis on which to incorporate administration fees: historical or current. There are a range of offsetting issues:

- Focus on 'past sins' or future outcomes: present administration fees almost certainly provide a better insight into future administration expenses than past fees.
- Potential for gaming. While some have raised concerns that present fees can be gamed to manage the test outcome, we consider the potential degree to be modest and other regulatory frameworks overseen by APRA should ensure sustainability and accountability of current administration fee structures.
- Whether a consistent approach between assessment of investment performance and administration fees is necessary. On one hand, looking at past performance and historic administration fees is more reflective of the historic consumer outcome. On the other hand, present fees are a better indicator of future consumer outcomes. A similar argument can be made that investment strategies may have been adjusted in response to historical performance, but this is effectively impossible to account for in a bright-lines test.

Overall, we think the test would be improved by using current, not historic, administration fees.

4. Assessment of updated YFYS reform package

In this section we summarise our views on each component of the YFYS reforms and consider important interactions between the respective reforms.

4.1. YFYS – Single Default Account (Your Super Follows You)

It is essential that a stapling model is introduced to remove the largest source of multiple account creation. However, it is also important to consider the most appropriate stapling model.

The single default account model detailed in the YFYS reforms (Diagram 1) differs from the stapling model recommended by the Productivity Commission (PC, Diagram 2) which

incorporated the 'Best in Show' concept. The third model is employment-based: a single superannuation account which moves with your employment (detailed in Diagram 3).

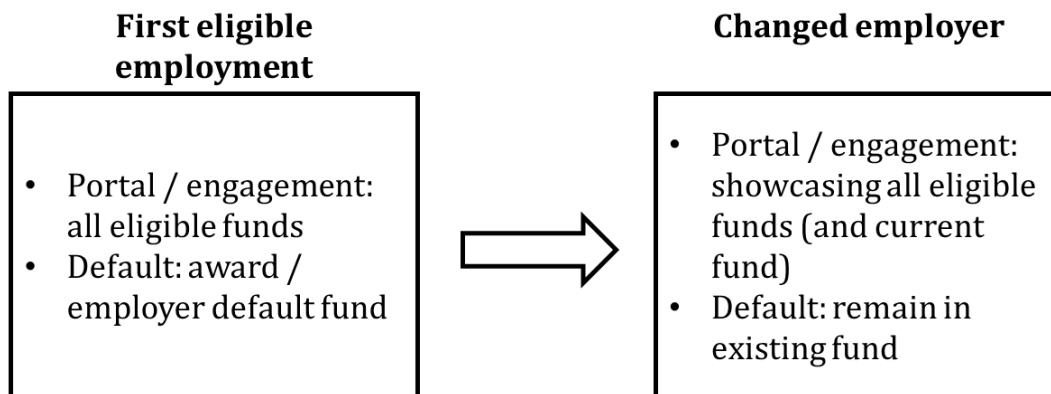


Diagram 1: Single Default Account workings - YFYS (interpreted into diagram).

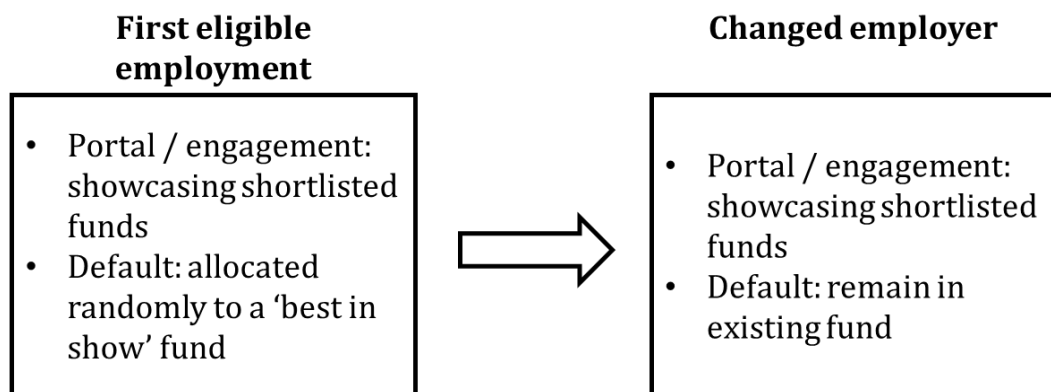


Diagram 2: Single Default Account workings - Productivity Commission (interpreted into diagram).

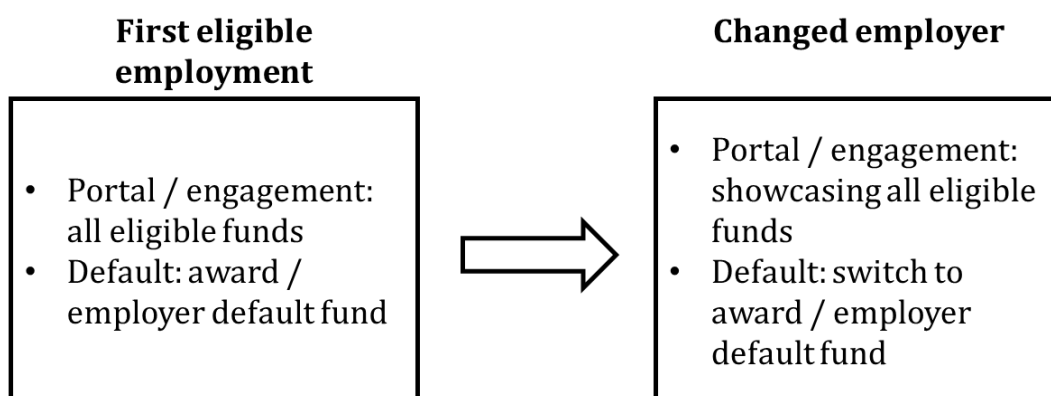


Diagram 3: Alternative single account model: single account which moves to new employer's default / award fund (interpreted into diagram).

Which model will deliver best outcomes for consumers?

- The benefits of the PC's model are largely hypothetical, as 'best in show' appears to be out of consideration. It creates a stronger baseline standard for new workers and an institutional competition lens. In the absence of this lens we are concerned that the baseline standard will be low and that competition risks being based largely on marketing

effectiveness rather than efficiency, innovation, and outcomes to consumers. The PC identified that the benefits of 'best in show' exceed the benefits of the performance test (see Appendix 3). Henceforth, we put this model aside.

- Transaction costs: there will be a higher level of switching costs associated with the employment-based stapling model compared to the YFYS model. Australians will commonly switch employment many times through their career. While those remaining within the same industry may remain in a relevant occupational super fund, there are many who will not. Our initial estimates (detailed in Appendix 4) are that the administrative cost of account switching under the occupational model would be in the order of \$120m pa; this cost is borne by the system because fund members are not charged account opening and closing fees. In addition, based on buy/sell spreads we estimate annual investment switching costs of approx. \$60m pa (these costs are directly borne by switching members).
- Insurance arrangements: concerns have been raised regarding the YFYS stapling model and appropriate insurance, specifically loss of appropriate insurance cover for people switching to an industry with unique risk factors. Countering these concerns are trustee obligations to provide appropriate insurance arrangements under a public offer arrangement. Ongoing APRA regulation and the likelihood of (and need for) a review of insurance in super will address this issue.
- Engagement through workplace partnerships: consumer engagement with super remains low. One source of engagement is via the employer. There are examples whereby default / award funds collaborate with employers to deliver effective engagement programs. Research suggests this improves financial wellbeing which benefits workplace productivity. This model is partly broken under the YFYS stapling model. But it is not completely broken as awards and defaults will still exist. The impacts of stapling will be slow to take hold and this will allow other effective engagement mechanisms to develop.
- Competition: we are concerned that the YFYS stapling model will not promote competition based on efficiency, innovation, and outcomes to consumers. Competition on these criteria can only be encouraged through an institutional competition lens. While the PC's 'best in show' model would have formalised institutionalised competition, the activities of regulators and research houses also promote institutional competition. Under the YFYS stapling model our concern is that competition will be consumer-based and marketing driven. This only improves member outcomes if the best marketers are also the best super funds. The ongoing role of regulators and research houses in engendering institutional competition is important.

Competition is not improved under the employment-based stapling model. Arguably, it represents a weaker competition model than the YFYS stapling model as it creates a comfortable competitive environment with many pre-ordained winners.

- Stapled to retirement solution: under any stapling model, consumers are stapled to the respective fund's retirement solutions and strategies developed as the Retirement Income Covenant takes effect. This highlights the importance of high-quality policy design and regulatory frameworks to ensure that retirement solutions, which will have significant impact on retirement outcomes, all meet a strong standard with minimal dispersion in outcomes.

Overall reflection

We reiterate that it is essential that a stapling model is introduced to remove the largest source of multiple account creation. The YFYS model directs the superannuation industry down a more developed public offer structure. Funds which cater to industry specialisation can still exist, but for non-first employment sectors consumers will need to make an active choice to become members, potentially advocated by employers and employee groups such as unions. This does not feel unreasonable for a modern workplace system. It is likely that this model will accelerate the rate of super fund industry consolidation.

The alternative, an employment-based stapling model, will incur a significant amount of transaction costs to be borne by the system, and ultimately consumers. For some sectors it will improve the appropriateness of insurance arrangements and may result in richer employer / fund engagement partnerships. There are pathways for these shortcomings to be addressed, such as improving insurance arrangements under a public offer framework.

Overall, we find that the significant and certain transaction cost savings under the YFYS stapling model anchors our decision compared with the other issues which, both for and against, are less tangible. We support the YFYS stapling model.

Over the longer term there are a range of considerations which we would expect to offset some of the concerns associated with the YFYS stapling model. Specifically, the industry will consolidate, the regulation of superannuation will continue to develop, insurance in super will likely be reviewed, and the role of employers and other parties such as government in engaging and educating consumers will further develop.

4.2. YFYS – Addressing underperformance in superannuation (Performance Test)

The impact of the recent changes to the YFYS performance test improve its effectiveness as a basic measure of implementation performance. The calculations detailed in Section 3.1 demonstrate that the YFYS performance test will generally be able to distinguish between good and bad implementation performance and will not overly constrain most super funds from implementing portfolios in the best interests of their members.

It is important to be clear on the purpose of the YFYS performance test:

- The YFYS performance test will not provide only limited insight into forward-looking relative performance. Too much important information is being put aside, notably changes made to governance, investment capability and investment strategy through time. However, the ramifications of failing the performance test may themselves contribute to performance headwinds (related to outflows and selling liquid assets to fund outflows).
- As such the YFYS performance test is effectively a ‘past sins’ test. Accordingly, analysis of the test needs to focus on two areas:
 1. Ensuring the YFYS performance test is a quality assessment of past performance to ensure fairness and acceptance (placing aside the question of whether a ‘past sins’ test applied retrospectively is fair).

2. Ensuring the YFYS performance test does not distort ongoing decisions of trustees away from investing for member best outcomes.

In our view (1) remains an issue while (2) is greatly improved following recent changes (additional indices).

The YFYS performance test could be far better. This is easy to identify when you consider which investment outputs are included in the test and which are ignored, as illustrated in Diagram 4.

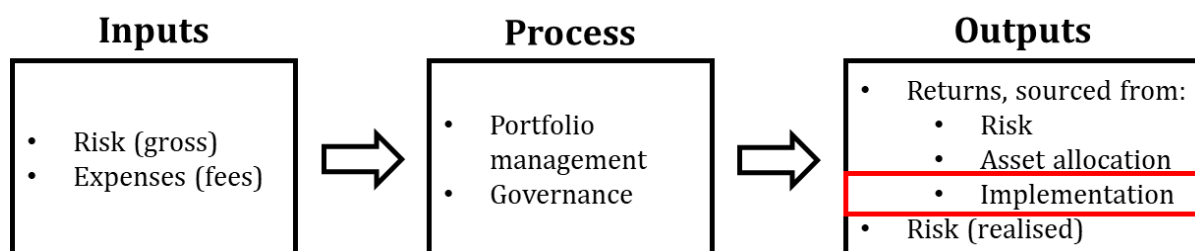


Diagram 4: Process representation of investment management. The red box highlights the elements assessed by the YFYS performance test.

4.2.1. Shortcomings of the YFYS performance test

We detail a range of shortcomings of the YFYS performance test:

1. The YFYS performance test doesn't account for the impact of SAA decisions

The decisions made by trustees around the choice of assets with which to populate their targeted risk exposure are important (known as SAA decisions – strategic asset allocation). As a simple example: allocating 10% more to global shares rather than Australian shares would have added 43bp per annum over the last 8 years.

We believe that SAA performance varies significantly between funds. To illustrate this, we have created a proxy for SAA performance based off APRA Heatmap results. This is illustrated in Diagram 5, from which we can make some important observations:

- The range in SAA performance between the best and worst funds is large, in the order of 1% pa. We acknowledge that this is smaller than the difference between best and worst implementation performance, which exceeds 3% pa.
- Performance due to SAA decisions appears independent of implementation performance.

Simply put, all sources of return impact superannuation outcomes. Trustees should be accountable for all investment decisions and associated outcomes. The YFYS performance test would be greatly improved by accounting for the returns based on SAA decisions.

The submission by the Actuaries Institute identifies, using APRA Heatmap data, is illuminating. They identify a pair of seemingly comparable funds with similar growth / defensive exposure profiles. One fails the proxy for the performance test while delivering higher returns than the other which passes the proxy for the performance test.

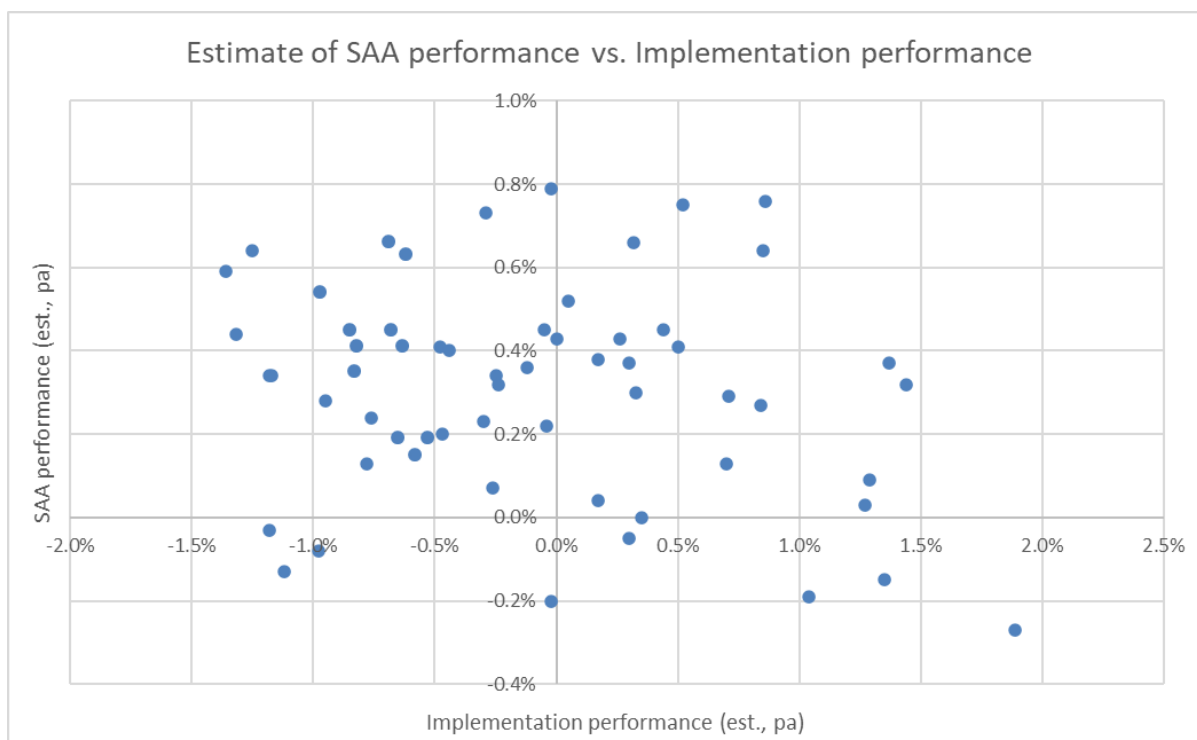


Diagram 5: Estimate of SAA performance versus implementation performance. Both numbers are based off the APRA Heatmaps and use 5yrs of data. SAA performance is estimated as: (Net Investment Return relative to Simple Reference Portfolio) – (Net Investment Return relative to Listed SAA Benchmark Portfolio).

2. The YFYS performance test is risk agnostic

The issue of risk is important. All else equal, members in funds with lower risk experience a narrower range of possible retirement outcomes, providing them with greater confidence. This has financial planning and wellbeing benefits. Funds actively manage the risk in their portfolios by putting together different assets which aren't expected to perform well at the same time. This is generally known as diversification. The YFYS performance test is agnostic to the management of risk. Indeed, in many cases the test penalises diversification and risk management strategies.

This is likely to create inconsistencies across policies. Consider the forthcoming Retirement Income Covenant: the focus is on reducing the risks to retirement income, yet risk is ignored in what is effectively the binding test for investment performance in accumulation.

3. Other concerns

We identify a large range of undesirable outcomes relating to how the test will impact the way super funds will manage their investments, consumer outcomes and impact on industry structure. Most notable is the potential for highly disengaged members to be negatively impacted as more engaged members leave the fund, likely impairing portfolio quality and forward-looking returns. These are detailed in Appendix 5.

4. Reliability

There are concerns around the reliability of the calculations. These concerns relate to:

- The self-reporting nature of data to APRA including SAA, fees, and expenses.

- A known categorisation effect, whereby there is flexibility around categorisation of assets such as unlisted assets and alternatives assets which result in inconsistent benchmarking outcomes.
- Lack of audit of collected data.

Given the strong penalties of failure all necessary measures should be taken to ensure reliability.

4.2.2. Creating a better YFYS performance test

The Working Group developed a set of design principles (Appendix 6) which guided much of its work on the YFYS performance test. One principle stands out as most pertinent:

The ramifications of failing any performance test need to be proportional to its reliability.

An improved YFYS performance test would achieve the following outcomes:

- Greater effectiveness at distinguishing between good and poor performing funds, accounting for all relevant sources of performance.
- Greater confidence in, and acceptance of, test results.
- Raise the baseline standard for the stapling process.

Our recommendation for a better test is straightforward:

⇒ Include an additional risk-adjusted return metric based on historical returns.

Our suggested metric is detailed in Appendix 7. We acknowledge similar recommendations from other groups – the concept is consistent.

We make the following points:

- To consumers it doesn't matter how complex the test is – the outcome for them will be a simple notification if their super fund fails the YFYS performance test.
- A risk-based metric accounts for the impact of SAA decisions and by nature, accounts for risk including diversification benefits.
- The risk-adjusted metric aligns more holistically with the concept of managing portfolios in members' best interests (i.e. accounts for all return sources and risk).
- An approach based on realised returns creates an element of the test which is based on audited data. There are no data and categorisation issues. In this regard the proposed second metric offsets many of the concerns regarding the current proposed metric.

Overall reflection

The impact of the recent changes to the YFYS performance test improve its effectiveness as a basic measure of historic implementation performance. It is important that super funds implement their asset allocation well. It is more important that they perform well overall for members. It is important that risk is managed well. It is important that the test is reliable. These flaws can all be broadly addressed in a simple manner: by adding a second metric based on realised risk-adjusted returns.

We believe APRA’s current approach, assuming strong implementation, will deliver superior outcomes to a ‘bright-lines’ YFYS performance test. It considers multiple metrics but also, through a frontline team, can account for changes made by funds to improve forward-looking return prospects. It can provide stronger insight into forward-looking returns for consumers. In our view the creation of a ‘bright-lines’ performance test will dilute the effectiveness of APRA’s approach with a negative relative impact on forward-looking consumer outcomes.

Over the longer-term we expect the impact of the YFYS performance will diminish as funds actively manage their outcomes. This may have some opportunity cost but far smaller now that additional benchmarks have been added.

4.3. YFYS – Best Financial Interests Duty

We believe it is important that industry accountability is improved. We support many of the components in this category.

Other submissions will undoubtedly highlight the risk of government intervention in investment and operational spending. We share those concerns and take the view that any outcomes of this nature risk inhibiting the achievement of member best outcomes. We believe there are other existing regulatory measures which address appropriateness of investment and expenditure. We also raise concerns, which others will address in more detail, regarding the operational burden of having no threshold limits.

We raise a single concern which relates to marketing, specifically the risk of a significant increase in industry marketing spend. This has been detailed in section 4.3.1. of our [Senate submission](#).

4.4. YFYS – Information Portal

We are concerned around how consumers will make an informed decision surrounding a fund identified as underperforming. Table 1 sets out a simple example of a fund (Fund A) which fails the YFYS performance test but delivers higher returns than one (Fund B) which passed the performance test.

Performance component	Fund A	Fund B
Implementation (YFYS Performance Test)	-0.5% pa	0% pa
Risk and asset allocation	7.5% pa	6.5% pa
Total performance	7.0% pa	6.5% pa

Table 1: Simple case study to highlight difficulties of communicating to consumers a failed performance test.

We consider the likelihood of the scenario identified in Table 1 to be almost certain (we note the submission by the Actuaries Institute which provides some examples based on APRA Heatmap results). We note in Table 1 that Fund A and Fund B have a similar level of overall risk exposure and, all else equal, would be expected to generate similar performance. Consider a member of Fund A who receives a letter notifying them that their fund failed the YFYS performance test and

referring them to a government-provided comparison website. Our reservations relate to various scenarios faced by consumers such as the following:

- They would see that Fund A outperformed some other funds (e.g. Fund B) which did not fail the test. How would this be explained?
- How will consumers balance issues such as performance, performance test results, administration fees and product risk?
- How will consumers access other important information such as insurance characteristics?
- What guides will there be to assist consumers to balance all the competing criteria and make a good quality decision?

Our understanding is that the information portal will not group investment options by risk category. If this is the case that would be a major concern as it would leave consumers with little to focus on besides looking for funds with the highest past returns.

4.5. Interactions

Given YFYS contains multiple reforms it is important to consider how the reforms will interact. We focus on one important interaction.

Stapling and the performance test

Concerns have been raised about the prospect of consumers being stapled to underperforming funds. This is a certain outcome. As discussed previously, we believe the YFYS performance test will only provide weak insight into future performance prospects. As such concerns need to be tempered about impaired future outcomes for impacted members.

Solutions to this problem are not forthcoming. At some point stapling needs to occur and there will be some funds which have failed the performance test. If stapling is deferred what mechanism will be used by Government to remove underperforming funds? This is somewhat a circular argument: if a mechanism was available then a bright-lines performance test may not have been required. One of the few possible mechanisms would be to shut down super funds which failed the performance test (i.e. no new and no existing members). In this case we would only be increasing the penalties applied to a test result which provides limited insights into forward-looking returns.

Searching for a solution to avoid stapling members to funds which failed the performance test risks further skewing the penalty relative to the consumer benefits of the test, given its limited insights into future performance.

5. Summary

Overall, we celebrate the positive intent of the reforms in Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (and associated regulations). In particular, the intent to remove unintended multiple accounts, create greater accountability for investment performance, improve transparency, and encourage engagement are noteworthy.

Our recent research efforts have focused primarily on further analysing the stapling model and the performance test.

The YFYS stapling model (single account) and the alternative employment-based stapling model have competing positive and negative impacts. By the time we account for the costs of account switching and the likelihood of a review of insurance in super, we believe the YFYS account-based stapling model is appropriate. The most important thing is that stapling proceeds and that the major source of multiple account creation is removed.

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The success of the reforms and the management of the sizable unintended risks they create will heighten the importance of a strong performing APRA. We suggest policymakers and regulators maintain a watch on whether the creation of a national consolidation fund would accelerate consolidation and protect heavily disengaged consumers.

7. Appendix 2 – Degree of investment strategy constraint: YFYS performance test

Updated analysis of the degree to which the YFYS performance test will constrain investment strategy. A summary of results which detail the updated assessment are included on a marked-up basis.

Degree of constraint

Previously:

“Common” Super Fund	“Stable” Super Fund
<p>Portfolio</p> <ul style="list-style-type: none"> - 30% total in unlisted property, unlisted infrastructure and high yield - Active management across many asset classes and management of ESG risks - This generates 3.6% tracking error <p>Performance Test</p> <ul style="list-style-type: none"> - 22% likely to fail the performance test - >80% likely to have to adjust the portfolio over time 	<p>Portfolio</p> <ul style="list-style-type: none"> - 10% total in unlisted property, unlisted infrastructure and high yield - No active management across and no management of ESG risks - This generates 1% tracking error <p>Performance Test</p> <ul style="list-style-type: none"> - <1% likely to fail the performance test - 10% likely to have to adjust the portfolio over time

Post-updates:

“Common” Super Fund	“Stable” Super Fund
<p>Portfolio</p> <ul style="list-style-type: none"> - 30% total in unlisted property, unlisted infrastructure and high yield - Active management across many asset classes and management of ESG risks - This generates 1.3% tracking error <p>Performance Test</p> <ul style="list-style-type: none"> - <2% likely to fail the performance test - Approx. 25% likely to have to adjust the portfolio over time 	<p>Portfolio</p> <ul style="list-style-type: none"> - 20% total in unlisted property, unlisted infrastructure and high yield - Active management across and management of ESG risks - This generates 1% tracking error <p>Performance Test</p> <ul style="list-style-type: none"> - <1% likely to fail the performance test - 10% likely to have to adjust the portfolio over time

Opportunity cost to consumers

Was:

	Assets (\$b)	Assets in DC (assumed)	DC Assets (\$b)	Assumed Current Tracking Error	Constrained Tracking Error	Opportunity Cost (\$b, per annum)
Retail	600	90%	540	<u>1.0%</u>	1.0%	<u>0.00</u>
Corporate	60	50%	30	<u>1.3%</u>	1.0%	<u>0.02</u>
Industry	760	90%	684	<u>1.3%</u>	1.0%	<u>0.41</u>
					Total	<u>0.43</u>

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8. Appendix 3 – The assessed benefits of ‘best in show’

The Productivity Commission estimates that a ‘best in show’ model provides as much if not more benefit to consumers as the performance test (in conjunction with the ‘Elevated Outcomes Test’). The PC identify that a ‘best in show’ model is essential to creating a competitive environment which rewards efficiency and successful innovation. The Figure A3 below summarises this using analysis produced by the PC.

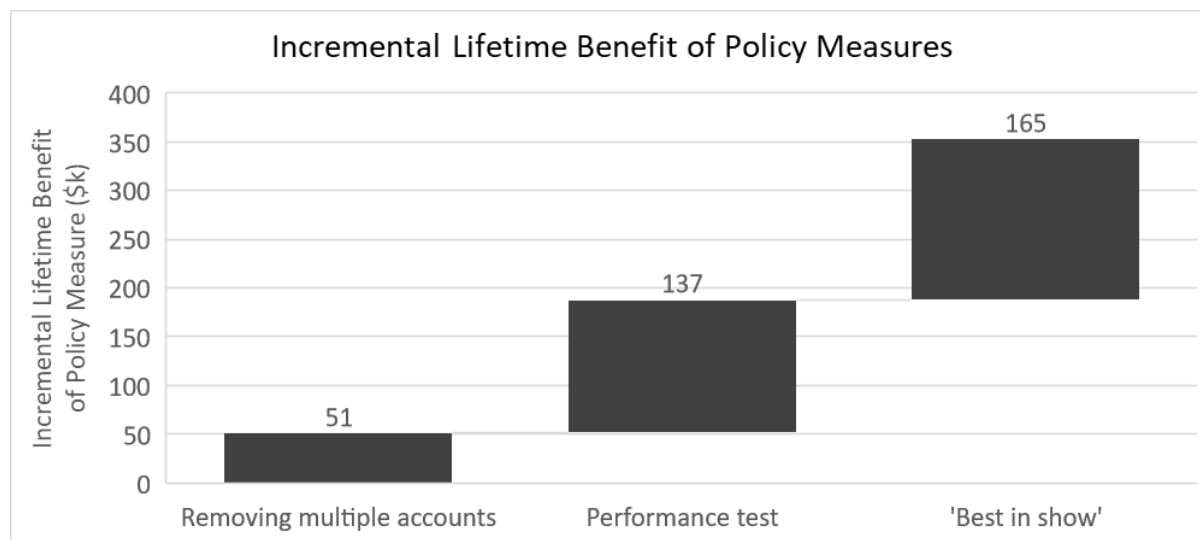


Figure A3: Incremental lifetime benefit of different candidate policy measures associated with single superannuation account. Numbers are sourced from Productivity Commission Inquiry “*Report Superannuation: Assessing Efficiency and Competitiveness*” (Meme 12.2 and Figure 12.1).

9. Appendix 4 – Assessed switching costs of an employment-based stapling model

The table below details the calculation of simple estimates of per annum switching costs associated with an employment-based switching model.

Assumptions		Notes
No. of superannuants	15,000,000	
Job switching frequency	12 yrs	
Assumed fund retention rate	75%	People staying in same default fund when they change job
Account opening / closing costs	\$200	
Buy / sell spread	0.12%	
Assumed account size	\$160k	Present average of five life stage average balances
Results		
Calculation		
Administration fee (est. pa)	\$125,000,000	
Investment fee (est. pa)	\$60,000,000	

10. Appendix 5 – Undesirable outcomes associated with the YFYS performance test

We identify a range of undesirable outcomes associated with the YFYS performance test.

	Issues identified
Concern 1: How funds will invest	<ul style="list-style-type: none"> • Despite additional benchmarks, some sectors, particularly alternatives, are assessed inaccurately. This deters the use of these sectors. • Dangerous incentive for funds which are well behind on the performance test to ‘swing for home runs’ and take high tracking error relative to benchmark. • Actively managing (in the worst case, gaming) the performance test by taking advantage of benchmark shortcomings. • Poor alignment with portfolio management approaches such as total portfolio approach (TPA). • Deterrent to strategies which reduce risk and provide diversification. • Features of the YFYS performance test do not match up well with future portfolio management challenges (e.g. potential low forward-looking return prospects).
Concern 2: Direct impact on consumers	<ul style="list-style-type: none"> • Given the low statistical effectiveness of the performance test super funds may ‘contest’ the result with their members, creating confusion. • The YFYS performance test result may create confusion for consumers when placed alongside total performance on the YFYS Comparison Tool. • Potential for a large cohort of funds to fail the YFYS test concurrently (due to benchmarking noise), reducing system confidence. • Penalises the heavily disengaged who may remain in a fund which becomes further impaired.

<p>Concern 3: Impact on industry structure</p>	<ul style="list-style-type: none"> • A deterrent to consolidation as funds will be hesitant to merge with other funds which may dilute their portfolio quality, impair their inflow profile, or distract management focus. • Potential for ‘zombie’ funds which are impaired partly due to the performance test, making them an unattractive merger partner.
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Table A5: Summary of undesirable outcomes likely to result from the YFYS performance test. For more details see the [Detailed Paper \(Nov 2020\)](#).

11. Appendix 6 – Working Group guiding principles for YFYS performance test

The Working Group developed the following set of agreed principles:

1. Developing an effective performance test is a great opportunity to improve superannuation outcomes for consumers.
2. It is important to minimise any undesirable outcomes created by introducing a performance test.
3. The ramifications of failing any performance test need to be proportional to its reliability.
4. Qualitative assessment by an entity such as APRA would acknowledge changes made through time by super funds to address past performance issues.
5. A well-designed collection of multiple metrics is likely to be more reliable and effective than a single metric.
6. If the intention is for a consumer outcome test, then it makes sense to include administration fees.

12. Appendix 7 – An additional metric for the YFYS performance test

This Appendix outlines a second metric to complement the proposed YFYS performance test.

The dual-metric test would work simply, as follows:

- Fail both metrics → fail the YFYS performance test.
- Don't fail both metrics → pass the YFYS performance test.

Overview of proposed metric

Explained simply, the second metric is calculated as outlined in Diagram A7.

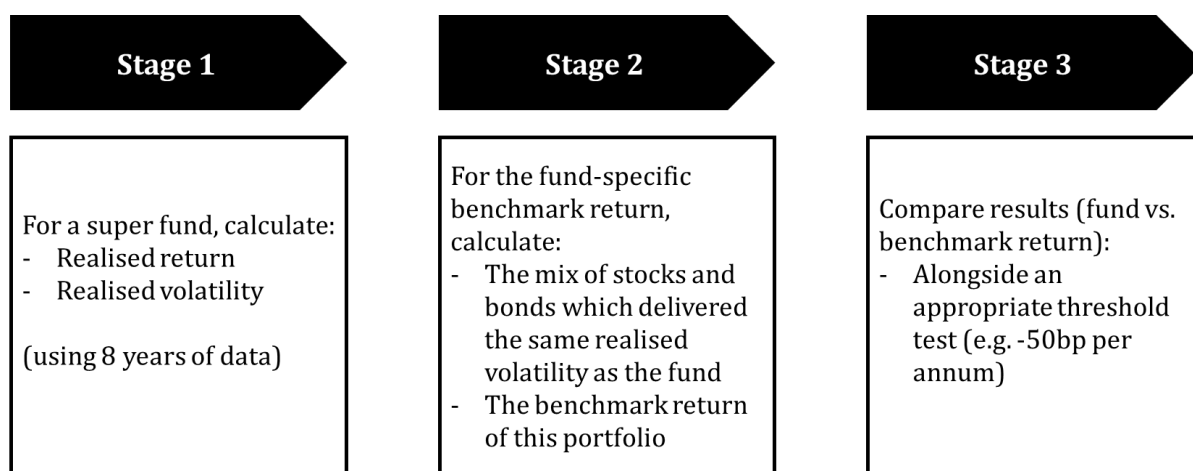


Diagram A7: Simple steps to calculate the proposed second metric.

Full detail is provided [here](#) (refer to Appendix 1). All that is required to calculate the proposed metric is a time series of performance (recommend monthly) and some existing benchmark indices. We note that this metric can easily be adjusted to include administration fees.