DEPARTMENT OF THE TREASURY
Annual Performance Test – Design Options Consultation

AMP Ltd. Submission

19 April 2024

INTRODUCTION

AMP would like to thank Treasury for the opportunity to outline our concerns about the Annual Performance Test (**APT**) component of the Your Future, Your Super (**YFYS**) policy.

As stated in previous submissions to Treasury and the Assistant Minister, while AMP is supportive of the YFYS policy as a whole, we do have reservations about the APT's application to products beyond MySuper, such as to the Choice investment options, given the complexity of those products, their inherent incomparability, and the significant unintended impact that test results have on members. AMP maintains these concerns and will reiterate some of them below in light of our own experience from the 2023 APT.

At the outset it is worth reiterating AMP's continued advocacy for amendments to the Capital Gains Tax (**CGT**) framework as it applies to the rollover of Choice investment options on wrap platforms. As Treasury is aware, AMP would like to see CGT relief extended so that members can be easily moved out of failed Choice investment options into alternative options without the potential for financial detriment to those members. This has been a major obstacle for trustees looking to find solutions for members invested in failed options on wrap platforms and will continue to be for the 2024 and subsequent tests. As such, CGT relief is still required to enable a trustee to act in the member's best financial interest given the CGT liability applies at the member level and can be a large barrier when considering the costs and benefits of moving members.

While CGT relief is important, AMP has written this submission relating to other very important issues that we hope to see prioritised this year. Our approach therefore has been to prioritise those issues that might be able to be resolved before this year's test in order to avoid a repetition of problems arising from the 2023 APT. We also make recommendations on other important topics, but recognise these will have a longer timeline for resolution.

AMP's priority issues to resolve for the 2024 test include:

a) **Retain current approach to assessment of administration fees** – In the main AMP supports the current approach to the test, but would particularly emphasise the importance of maintaining the approach to assessing administration fees, i.e. using the fee from the most recent financial year. This approach is appropriate and has had the effect of substantially reducing fees across the industry. There remains room for fees to continue to be lowered and for that reason the assessment method should be maintained. To change the assessment method to a multi-year average, as was proposed at the inception of YFYS, would give funds the ability to lift fees without facing performance consequences for some time, and should therefore be avoided.

b) **Higher representative balance for platform administration fees** – The representative balance should be lifted from the current $50,000 balance to something that is more representative of the average account balance for platforms and typically reflect the administration fees for that balance. The dollar-based account fees should also be prorated against the average number of investment options held by members to get a more realistic view of how those fees are actually applied to member accounts.

c) **Level playing field for Choice products** – Currently only a small proportion of multi-sector/diversified Choice investment options are being tested as, thanks to a quirk in legal definition, the majority of options are excluded on the basis that they are ***not*** managed by a connected entity of the trustee. To ensure an level playing field and to ensure all super members invested in diversified Choice products are receiving the same information, AMP recommends that i) Treasury immediately delete paragraphs (b) and (d) of regulation 9AB(7) of the *Superannuation Industry (Supervision) Act 1993, ii)* Treasury subsequently develop a more suitable assessment for diversified Choice products which is aligned to ASIC in Report *779 Superannuation and Choice Products*. If Treasury does not adopt these recommendations, then the APT should be extended to apply to all diversified external-directed products (**EDPs**) by 2025.

d) **Principles-based fail notices for Choice options** – Following the 2023 APT, AMP's own experience was that members found the fail notices they received from the Trustees to be highly confusing and as a result, uncertain what they should do. For 2024, AMP encourages Treasury to move away from a prescriptive fail notice to a principles-based one for Choice products. This gives trustees the flexibility to ensure the notices are fit for purpose according to the different member cohorts so that it is more representative to them, rather than every member receiving the same generic notice.

e) **Exempt capital-guarantee products from the test** – Current regulations attempt to ensure that capital-guaranteed products are excluded from the APT. The basis for their exclusion is that they be invested wholly in a life policy. However, some capital-guaranteed products are not invested in a life policy, and consequently are captured by the APT. It is important for members in these products that the exclusion applies equally for the 2024 test.

AMP has prioritised these issues in our submission because we believe they will provide the most benefit for members via the quickest route in the short time available before the 2024 APT cut off. Importantly, it is our understanding that these priority issues exist in regulations rather than legislation and hence can be dealt with relatively quickly.

As always, AMP is committed to offering competitive products that deliver real benefits to our members. We will always advocate for policy settings that encourage innovation and finding solutions for the diverse needs of our members and that enable them to have choice over their financial futures.

SUMMARY OF RECOMMENDATIONS

Recommendation 1:

AMP recommends Treasury retain the current approach to the assessment of administration fees under the Annual Performance Test

Recommendation 2:

The representative balance in the test should be lifted from the current $50,000 balance to something that is more representative of the average account balance for platforms. Also, the dollar-based account fees in the test should be prorated against the average number of investment options held by members of wrap platforms.

Recommendation 3:

AMP recommends that Treasury delete paragraphs (b) and (d) of regulation 9AB(7) of the *Superannuation Industry (Supervision) Act 1993* as the trustee is not involved in the setting of the SAA or managing the assets of the fund (in line with the original YYFYS policy).

Additionally, we would recommend Treasury subsequently develop a more suitable criteria or assessment for diversified choice products which is aligned to ASIC in Report *779 Superannuation and Choice Products*. This is a more suitable and appropriate approach for diversified Choice options and is aligned with member expectations.

Recommendation 4:

AMP recommends Treasury move to a principles-based approach to formulating fail notices for diversified Choice options.

Recommendation 5:

AMP recommends the existing exception in sub-regulation 9AB.2(6) of the SIS Regulations is immediately amended to ensure that it applies to all capital guarantee products including those that are wholly invested in a life policy as well as products based on more contemporary approaches

Recommendation 6:

AMP recommends Treasury not consider extending the annual performance test to retirement products until after the accumulation phase test is settled and fully embedded.

Recommendation 7:

For options with multiple investment pathways, AMP recommends that Treasury disaggregate each pathway, test each separately, and limit consequences to within each pathway

Recommendation 8:

AMP recommends that Treasury not extend the APT to single-sector options and remove the options that are commonly regarded as ‘single-sector’ which are caught by the APT.

SECTION 1 – PRIORITY ISSUES TO BE DEALT WITH FOR THE 2024 APT

a) Retain current approach to assessment of administration fees

It is critical that the APT continues to assess superannuation funds based on current administration fees in order to continue to drive better outcomes for superannuation fund members.

The use of the current administration fee continues to be working to strongly incentivise trustees to reduce administration fees, and to maintain them at a low level. Since the inception of the APT, we have witnessed administration fees drop significantly across the superannuation industry, and this continues with a drop from 0.32% to 0.28% p.a. from 30 June 2021 to 2022, and a further drop to 0.26% p.a. at 30 June 2023 (figures for a $50,000 balance sourced from KPMG SuperInsights report). This is a very positive outcome for members.

In contrast, switching to a historical average fee not only removes that incentive, but perversely gives trustees an opportunity to raise administration fees knowing the impact will not significantly shift their historical fee average for some time. Rather than reducing fees and maintaining them at a low level to the benefit of members, this approach would almost certainly lead to a sustained higher average fee for members over time.

In addition, there are also significant data issues – that is, problems and gaps with the historical administration fee data which has been submitted to APRA. In the past several funds have failed to report administration fee data, or, as in the early years of the test, have reported an administration fee of zero, artificially lowering the benchmark RAFE. As such, any assessment using this data will be an inaccurate measure of the actual fees paid by members of those funds, skewing the entire performance test. It would be an unfair test for funds that have submitted incomplete or incorrect data in error to be favourably compared to funds which have accurately submitted their data according to the APRA requirements.

Further, the historical fee data submitted to APRA would not support a reliable comparison of products on a like-for-like basis, particularly as administration fees for some products would be significantly understated. This is because historical data does not include amounts transferred from reserves to fund administration costs, a common practice in some parts of the superannuation industry. Such transfers have only relatively recently been reported to APRA as part of the administration fee.

An accurate reconstruction of historical administration fee data held by APRA on a consistent and equitable basis across the industry, with accurate and tax-consistent reporting of administration fees including transfers from reserves, to establish complete and accurate data would require resubmission of all prior years' data. This would be a difficult or even impossible task especially given the recent merger activity may preclude access to historical records for many funds.

Recommendation 1:

AMP recommends Treasury retain the current approach to the assessment of administration fees under the Annual Performance Test.

b) Increase representative balance for platform administration fees

Dollar-based administration fees for Choice products apply at the account level. As such, assessing the full value of the dollar-based administration fee in the performance test for each investment option is not reasonable and will not reflect current or likely future member outcomes.

Members invested through wrap platforms hold on average five to seven investment options. This is different to MySuper products, where, for example, members almost always have their whole balance invested in the default MySuper investment option. For platform members the dollar account fee should be prorated against the number of investment options held to get a more realistic view of how to treat these types of fees.

The basis for setting platform administration fees includes the features and functionality that are made available, the diversity and range of investments and the services provided to members and their advisers. Platforms are advised products, designed for mass affluent ($250k plus balances) and high net worth superannuation members. At these higher balances, platform administration fees are designed to provide a very competitive outcome for members, compared to the hypothetical balance of $50,000 used in the performance test.

For wrap platforms, the representative balance in the annual performance test should be lifted from the current $50,000 balance to something that is more representative of the average account balance for these products to better reflect the actual experience for the majority of members in these options. Currently the test applies to balances for less than 10% of our members but implies all members have had that experience. This is misrepresents the actual experience of the majority of members.

Recommendation 2:

The representative balance in the test should be lifted from the current $50,000 balance to something that is more representative of the average account balance for platforms. Also, the dollar-based account fees in the test should be prorated against the average number of investment options held by members of wrap platforms.

c) Level playing field for Choice products

AMP notes that the current definition of trustee-directed products (**TDPs**) includes where the trustee invests in a product offered by a ‘connected entity’ which can include the fund manager or responsible entity (RE) of a managed investment scheme. A TDP can include both ‘arms’ length’ products, which are available for other trustees to offer on their platforms and may be available to non-superannuation investors, and ‘non-arms’ length’ products where the trustee may maintain influence over the strategic asset allocation or other factors associated with the investment option. With the former, the trustee has no control or influence over the design and implementation of the investment strategy of the product. Moreover, the RE of the product made available on wrap platforms is responsible for the governance and all decisions about the investment strategy. Given this, that makes an ‘arms’ length’ product more akin to an EDP, which are not included in the test.

For registered managed investment schemes, a related party RE cannot by law be influenced by the directions of one unitholder (the trustee). Were a trustee to influence the investment decisions of a related party RE, the RE would be in breach of its legal duties under both trust law and Chapter 5C of the Corporations Act 2001, and would be very likely to be the subject of action by ASIC.

The definition of TDP should exclude ‘arms’ length’ products where the trustee has no control or influence over the design and implementation of the investment strategy of the product.

Applying the test to TDP options where the investment decisions are made by a related party but not the trustee itself, leads to the following difficulties and anomalies:

- the test causes consumer harm if a trustee is forced to move members from that TDP option (because it was tested and failed) to a non TDP option that is exempt from the test, but had the test applied, would have also failed
- the client or their adviser moves a client to a different platform (super fund) where the same option is offered but it is not tested on that target platform because the trustee and fund manager/RE are not a connected entity
- the effect is an uneven playing field for trustees and their members. Where the trustee offers a wide range of diversified investment options to members at ‘arms’ length’, but because some of those options are offered by a connected entity are classified at TDPs and subject to the test, while the non-connected options are not tested.

In AMP’s view, the focus of performance testing for diversified Choice options should be more about the process followed when a trustee identifies an underperforming underlying accessible investment option more broadly.

This process should be in accordance with the views set out by ASIC in Report *779 Superannuation and Choice Products.* This is a more suitable and appropriate approach for diversified Choice options and is aligned with member expectations.

Until it is decided that **all** diversified Choice investment options should be subject to a ‘test’ and treated consistently, AMP recommends that the TDP options offered at ‘arms’ length’ (where the trustee does not influence the investment decisions) should be immediately excluded from the APT, even if the decisions about that option are made by a related party.

In the meantime, Treasury should develop a more suitable criteria or assessment for testing diversified choice products which is aligned to ASIC in Report *779 Superannuation and Choice Products*.

Recommendation 3:

AMP recommends that Treasury delete paragraphs (b) and (d) of regulation 9AB(7) of the *Superannuation Industry (Supervision) Act 1993* as the trustee is not involved in the setting of the SAA or managing the assets of the fund (in line with the original YYFYS policy).

Additionally, we would recommend Treasury subsequently develop a more suitable criteria or assessment for diversified choice products which is aligned to ASIC in Report *779 Superannuation and Choice Products*. This is a more suitable and appropriate approach for diversified Choice options and is aligned with member expectations.

If Treasury were not to adopt these first 2 recommendations, then the APT should be extended to apply to all diversified EDPs by 2025 to ensure members in all diversified Choice options are being treated equally.

d) Amend trustee fail notices

Following the 2023 APT, AMP found the trustee notices written to members in failed trustee-directed products did not have the intended impact as a message designed for members. AMP conducted a survey of its aligned advisers with the following findings:

- The principal issue is the confusion the notices cause to members, followed by the additional cost burden to members of seeking advice to understand the letter.
- Following the 2023 APT AMP conducted a survey of our advice network on their experience with clients who had received a letter from our Trustee. Findings included:
    - 74% of members who received a trustee letter were unable to understand exactly what the letter was indicating
    - Only 16.7% of client queries were able to be resolved immediately
    - 44% required an appointment with an adviser
    - 25% were unable to be resolved due to the client being unwilling to pay for the advice
- Further, the language of the letter is overly 'legalistic', a very different approach to the communications usually sent by trustees. As such it loses the broader context of the trustee-member relationship that exists with those other communications.

AMP encourages Treasury to consider moving to a principles-based approach to formulating notices that will provide trustees with more flexibility to ensure members are appropriately informed and confusion is reduced.

More specificity is required. Therefore, some suggested drafting principles may include:

- A statement to the effect that one or more investment options in which the member is invested has failed the annual performance test and the member should think about moving their money to a different investment option or fund.
- If any investment options in which the member is invested have failed the annual performance test for at least two consecutive years, a statement that the investment option is not able to accept new members until it passes a future test.
- The balance of the member's account as at 30 June in the calendar year in which the notice is issued and as calculated for the purposes of the periodic statement issued, or to be issued, to the member in accordance with s 1017D of the *Corporations Act 2001.*
- Details of the investment option(s) that failed the annual performance test, including the balance of the member's investment in each failed option as at 30 June in the calendar year in which the notice is issued.
- The total fees and costs charged to the members account in the relevant financial year excluding insurance and advice fees as calculated for the purposes of the periodic statement issued, or to be issued to the member in accordance with s 1017D of the *Corporations Act 2001.*

- A statement to the effect that the member's money will stay in the failing investment option(s) unless they move it.
- Information about how the member can consolidate their super if they choose to, including by contacting the new fund or using MyGov.
- A warning to the effect that before switching investment options, the member should think about their individual circumstances, needs and objectives, including but not limited to, existing investment plans, potential loss of insurance or other benefits, fees and costs and tax impacts and that they may wish to speak to a financial adviser about their personal circumstances and options.
- A statement to the effect that the annual performance test and the information provided in the notice do not consider the member's personal situation or the actual fees and tax payable in respect of their investments in the fund.

Recommendation 4: AMP recommends Treasury move to a principles-based approach to formulating APT fail notices for Choice products.

e) Extend capital guarantee exception

Under existing APT regulations, an investment option that provides a capital guarantee is not considered a TDP if the underlying assets are wholly invested in a life policy, which ensures that these products are not subject to the performance test.

However, this exception does not extend to more contemporary capital guarantee products that are *not invested in a life policy,* causing significant difficulty for members in those products.

AMP North Guarantee is an example of a capital guarantee product that is not wholly invested in a life policy. North Guarantee is managed using a range of market instruments and shareholder backing which allow the guarantee to be provided to members at a lower cost, and higher growth exposure, than a traditional guarantee invested in a life policy.

Testing guarantee products

Members invested in capital guarantee products can generally be characterised as having a low tolerance to investment risk. The APT assessment approach does not provide a risk adjusted return measure which is the core value proposition and design of these investment strategies. In addition, the test is not a holistic assessment of these options as the APT outcome solely focuses on performance of the underlying investment without considering the holistic member outcome, in this case the protection provided by the guarantee and at a lower cost outcome than comparable life policy backed products might provide.

If a member, in response to receiving an APT failure notice that the capital guarantee product has failed the performance test, moves their money to a different product, they will terminate the guarantee and forfeit a proportion of the benefit they would have otherwise received and have paid for.

The member will also be liable to pay tax on any capital gains arising. Members in this circumstance will be financially worse off due to the operation of the performance test consequences.

All products which offer members the benefit of protecting their investment against negative returns or a reduction in the value of underlying assets should be excluded from the performance test irrespective of how the capital guarantee feature is designed or managed.

Recommendation 5:

AMP recommends the existing exception in sub-regulation 9AB.2(6) of the SIS Regulations is amended to ensure that it applies to all capital guarantee products including those that are wholly invested in a life policy as well as products based on more contemporary approaches.

SECTION 2 – MEDIUM-TERM IMPROVEMENTS

a) Extending the APT to retirement products

AMP does not support the extension of a performance test to retirement products until after the the accumulation phase test is fully settled and embedded.

Retirement products are much more difficult to assess given the wide range of member objectives they serve and benefits they offer beyond returns. Further, for members who are already in retirement products, if testing of their products were to exhibit similar methodological problems to those seen in MySuper and Choice products, the impact on member outcomes could be more severe, particularly if they lose certain benefits by switching to a product that simply hugs the benchmark.

A performance test of retirement products would also very likely stifle innovation at a time when the industry is attempting to get new products to market that better serve members' varying and individual retirement needs. Beyond an account-based pension, it may better suit some retirees to have more complex products, or range of products, the benefits of which will not feasibly be able to be assessed by an APT.

Recommendation 6:

AMP recommends Treasury not consider extending the annual performance test to retirement products until after the accumulation phase test is settled and fully embedded.

b) Options with multiple investment pathways

For options with multiple investment pathways, each pathway should be tested separately with consequences limited to the specific pathway.

Current regulation stipulates that where a product that is subject to the performance test has multiple investment pathways, that product will be tested based on the asset-weighted average of the standard (highest) administration fee for each pathway and the lowest actual return (highest investment fee) across all pathways.

This approach does not reflect actual member experience and performance test results are consequently confusing and misleading. This results in consumer harm by virtue of members acting on inaccurate test results. For example:

a) members invested in a pathway that would have passed the performance test if assessed separately will receive a 'fail' notice recommending that they consider a different product; and
b) members invested in a pathway that would have failed the test if assessed separately will not receive notice that the pathway in which they are invested has failed.

Disclosure of inaccurate results for products with multiple investment pathways undermines confidence in financial advice and significantly increases the cost of advice as members feel the need to consult their adviser to consider alternate investment strategies.

Subsequently, it is difficult for financial advisers to balance the fail notice recommendation with their best interest duty, thereby struggling to move a client to a different product when, based on actual performance, the adviser has determined it is in the member's best interest to remain invested in that pathway.

Recommendation 7:

For options with multiple investment pathways, AMP recommends that Treasury disaggregate each pathway, test each separately, and limit consequences to within each pathway.

c) Performance testing of single-sector options

Superannuation members in wrap platforms generally invest in a portfolio that contains a mix of single-sector options as part of a broader diversified portfolio. Each option serves a specific purpose as part of portfolio construction (balancing styles, market cap, downside protection, diversification, etc). As such, the current approach of assessing each single-sector options on a stand-alone basis using the current single-metric test, is not appropriate. It is not clear that it would be very meaningful to the member either, given their entire portfolio needs to be considered together to provide an overall picture of the performance of their superannuation.

There are over 15 different single-sector asset classes and over 50 different sub-asset classes. There are also specialised strategies including geared strategies, low-volatility strategies, benchmark unaware, income focused, sustainability, tax conscious and so on. Traditional market indices are not appropriate to assess performance for these specialist strategies.

AMP's wrap platform alone offers over 500 single-sector options and over 150 distinct benchmark indices are used to support internal monitoring of these options.

Considering the diverse range of single-sector options available to superannuation members, it is not reasonably practical to include a sufficient number of new benchmark indices to support extending the performance test to these options.

Recommendation 8:
AMP recommends that Treasury does not extend the APT to single-sector options. We also recommend that Treasury remove the options that are commonly regarded as 'single-sector' which are caught by the APT.