Institute for Sustainable Futures

The Superannuation Performance Test and Net Zero Transition

Prepared by
Institute for Sustainable Futures

April 2024

Institute for Sustainable Futures
University of Technology Sydney
Level 10
235 Jones Street
Ultimo NSW 2007

Postal Address
PO Box 123
Broadway NSW 2007
+ 61(02) 9514 4160

ABN: 77 257 686 961

Authors
Gordon Noble, Alison Atherton, Donna Lopata

Institute for Sustainable Futures
University of Technology Sydney
PO Box 123 Broadway, NSW, 2007
www.isf.uts.edu.au

Summary

Thank you for the opportunity to contribute views in relation to Treasury's *Annual Superannuation Performance Test - design options Consultation paper*.

The UTS Institute for Sustainable Futures (ISF) is an interdisciplinary research and consulting organisation at the University of Technology Sydney with over 100 research staff and students. ISF has been working collaboratively since 1997 with governments, businesses, organisations and communities to create change towards sustainable futures.

Our work in Australia and around the world aims to protect and enhance the environment, human well-being and social equity. We work with financial system participants to advance sustainability, prosperity and well-being through sustainable finance and investment. We deliver bespoke research and capacity building services with a focus on partnering to establish a sustainable finance learning ecosystem.

UTS ISF is cognisant of the important role of the Annual Superannuation Performance Test in protecting Australians' retirement savings and holding trustees to account. In addition to delivering the best financial outcomes for members we note the proposed objective of superannuation[1] to support a '*dignified'* retirement '*in an 'equitable and sustainable way'*. The objective of superannuation consultation paper elaborates on these terms, explaining "dignified" to denote wellbeing in retirement, whilst "equitable and sustainable way" is defined as fitting within Australia's broader fiscal strategy. We believe that achieving both of these objectives is deeply connected to a transition to net zero. UTS ISF comments then are specifically related to barriers and solutions to superfund allocation of capital to support net zero transition as well as alignment with the Australian Government's Sustainable Finance Strategy consultation paper[2] seeking a "*significant amount of private and public investment. It is important that financial markets are well placed to finance this transition and therefore support the Government's emissions reductions target*."

We are not proposing that the Australian Government make wholesale changes to the annual performance test. We support retaining the status quo but improving the current testing framework.

Our key concern with the current framework is the lack of benchmarks for early-stage companies and other climate solution investments that support transition to net zero emissions.

The desire of superannuation funds that have made net zero commitments to support Australia's net zero transition need not be impeded by the lack of appropriate indices. Further, CPG 229[3] notes that the "*financial risks associated with climate change have a number of elements that distinguish them from other financial risks*" and elaborates on the need for longer-term assessment of risk and opportunity. In understanding the unique nature of climate change risks we believe that the Annual Superannuation Performance Test should also incorporate the ability for funds to respond to climate risk and invest in feasible climate solutions.

A proposed solution is to establish a net zero aligned science and technology framework as a mechanism to benchmark a specific set of investment opportunities where there are either no benchmarks, or where for a range of factors benchmarks are not mature.

We propose issues that could be considered in designing a net zero aligned science and technology innovation framework.

The benefit of establishing a benchmark for specific types of investments would be to not only support funds to deliver risk adjusted returns in a way that aligns with their net zero investment objectives, but support building sustainable industries in Australia. This is important in the context of the Australian Government's Sustainable Finance Strategy for Australia that outlines principles and priorities to *"mobilise the private sector investment needed to support net zero, Australia becoming a renewable energy superpower and*

---

[1] https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr7111%22
[2] https://treasury.gov.au/consultation/c2023-456756
[3] https://www.apra.gov.au/sites/default/files/2021-11/Final%20Prudential%20Practice%20Guide%20CPG%20229%20Climate%20Change%20Financial%20Risks.pdf

other sustainability goals." The cost of not enabling net zero aligned early-stage company investment is that companies will seek opportunities to commercialise offshore.

We note that it can be expected that many of the new businesses that will drive net zero transition will be based on new science, technology and innovations that will come out of, or rely on, expertise held across Australia's university sector. There is specifically an opportunity for the Australian Government to support partnerships between Australia's superannuation industry and Australian universities to accelerate the development and deployment of world-leading net zero science and technology investments at speed and scale.

Performance Test and Net Zero Transition

The intent of the superannuation fund performance test is to benchmark superannuation fund performance against listed indices with the number of indices expanded from the Productivity Commission's nine to the current list of twenty indices that include unlisted asset classes such as infrastructure.

A key challenge is that for some emerging asset classes appropriate indices do not exist or are not mature.

An area where the lack of appropriate indices has the potential to impact on investment allocation in early-stage companies that are developing science-based innovations that have the potential to support net zero transition.

For a number of reasons, it is challenging for superfunds to invest in early-stage companies that develop and deploy new science and technology which is critical to support net zero transition. We use the words 'early-stage companies' rather than venture capital because superannuation funds will use different structures, including direct investment, depending on their investment philosophy and size.

A particular concern is that the lack of benchmarks for early-stage companies can limit the allocation of capital by superannuation funds to specific types of investment.

We emphasise the importance of developing a science and technology innovation framework in the context outlined in the draft Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information. AASB[4] note that information on climate-related risks and opportunities that may reasonably be expected to affect an entity's prospects often falls outside of general purpose financial reports. Other jurisdictions such as the SEC in the US[5] have also responded to IFRS S2 Climate-related disclosure standards[6] with new rules to improve climate risk reporting. With the absence of this information the market-capitalisation based indices on which the Annual Superannuation Performance test is built do not properly incorporate climate risk.

Proposed Solution

We propose the development of a net zero aligned science and technology innovation framework as a mechanism to benchmark a specific set of investment opportunities where there are either no benchmarks, or where for a range of factors benchmarks are not mature.

Framework criteria could include:

- Investments would only be carved out of consideration of superannuation fund performance test if they met a set of criteria that would be determined through a consultative process. Considerations could include alignment with the Sustainable Finance Taxonomy and Sector Decarbonisation Pathway Plans. [7,8]

- An investment would be eligible for inclusion in the new benchmark only for a set period of time during which the investment can be expected to reach a level of maturity and confidence in the proposed benchmark would grow.

---

[4] https://www.aasb.gov.au/admin/file/content105/c9/AASBED_SR1_10-23.pdf

[5] https://www.sec.gov/rules/2022/03/enhancement-and-standardization-climate-related-disclosures-investors
[6] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards-issb/english/2023/issued/part-a/issb-2023-a-ifrs-s2-climate-related-disclosures.pdf
[7] https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/investor-roundtable-help-modernise-economy-maximise-advantages
[8] https://www.dcceew.gov.au/climate-change/emissions-reduction/net-zero

- A superannuation fund would have an overall cap relative to AUM that would be eligible for investments eligible for inclusion in the new benchmark. The size of the cap would be determined so it did not impact on the integrity of the superannuation fund performance test.

- Investments eligible for the new benchmark would need to demonstrate how they contribute to net zero transition. The framework could establish an agreed mechanism to provide assurance around both the maturity of a new science related technology and opportunities to support net zero transition. The success of the Joint Ore Reserves Committee (JORC) in supporting mining investment over the last fifty years can be used as a starting point.

- Investments eligible for the new benchmark would be required to meet best practice sustainability reporting criteria including reporting against International Sustainability Standards Board and Australia's proposed climate-related financial disclosure criteria.

- Investments eligible for the new benchmark would be subject to a competency assessment that would be based around testing the depth and quality of skills and knowledge of the entity providing the investment solution.

- A superannuation fund that has elected to benchmark early-stage companies and other climate solution investments against the net zero aligned science and technology innovation framework could be labelled as a signal to members that the fund is delivering retirement income for a dignified future in an equitable and sustainable way.

Consistency with legislation

Treasury Laws Amendment (Your Future, Your Super) Bill 2021 introduced requirements for an annual performance test that would be set out in regulations. The Explanatory Memorandum for the Bill states:

"It is expected that the regulations will be made for this purpose that include, but are not limited to the following matters:

- *specifying requirements in respect of investment returns (which may be net of fees and taxes); and*

- *specifying requirements that depend on the exercise of a discretion by APRA; and*

- *specifying matters that APRA may or must take into account in exercising such a discretion; and*

- *allowing APRA to make specified assumptions in exercising such a discretion.*

Furthermore, the amendments clarify that, in specifying requirements, regulations may include requirements based on a comparison between actual returns for a product and a benchmark return. The regulations may include different methods for these calculations. Such methods may involve assumptions to be made in applying the method, which may be specified in the regulations, such as assumptions as to rates of tax or fees or other matters. The regulations may also set out circumstances (including pre-conditions for) when APRA has discretion to depart from such assumptions by legislative instrument."

The intent of the legislation was to enable comparison of investments against benchmarks. It was not to exclude certain kinds of investments. Consistent with Australia's principles based regulatory framework, APRA is empowered to determine appropriate benchmark. In the absence of a market benchmark, it is consistent with the legislation for APRA to determine an appropriate way of benchmarking performance for early-stage science and technology investments.

Benefits

We refer to the five key concerns raised in the YFYS review,

- Focusing on investment implementation over other measures of performance,
- Encourages short-term decision making,
- Incentive to hug benchmarks,
- Lack of investment flexibility,
- Reduced choice, diversification, and active management

We propose the introduction of a net zero aligned science and technology innovation framework as a mechanism that addresses these concerns in a way that simultaneously ensures the improvement of returns for members. The benefit of carving out early-stage companies that have the potential to support net zero transition from superannuation fund performance text benchmarks would be to support the legislated objective of superannuation alongside the development of sustainable industries in Australia. One of the concerns is that the lack of opportunities for net zero aligned early-stage companies to attract superannuation capital is leading some to consider opportunities offshore.

Australia has the fourth largest pool of retirement assets in the world, with Australia's superannuation system currently at $3.4 trillion projected to grow from 116 per cent of GDP in 2022–23 to around 218 per cent of GDP by 2062–63[9]. Australia's superannuation system has the potential to reach $9 trillion in assets by 2041[10].

As Australia's superannuation capital grows there is an opportunity to align with the Australian Government's net zero emissions ambitions. The majority of the largest twenty APRA-regulated superannuation funds have already made their own net zero emission commitments. Their commitment aligns with CPG 229 that details trustee duty to consider climate-related financial risk. Addressing this risk requires the introduction of a unique benchmark, we propose as the net zero aligned science and technology innovation framework.

We note that it can be expected that many of the new businesses that will drive net zero transition will be based on new science, technology and innovations that will come out of, or rely on expertise within, Australia's university sector.

There is an opportunity for the Australian Government to support partnerships between Australia's superannuation industry and Australian universities to accelerate the development and deployment of world-leading net zero and circular economy technologies, at speed and scale.

---

[9] https://treasury.gov.au/sites/default/files/2023-08/p2023-435150.pdf

[10] Dynamics of the Australian Superannuation System | Deloitte Australia