Annual Superannuation Performance Test — Design Options

Aware Super Submission

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Contents

Executive Summary

Aware Super welcomes the opportunity to provide comments on The Treasury's Annual Superannuation Performance Test — Design Options Consultation Paper. We also acknowledge the considerable work that has gone into producing and consulting on the paper to-date.

It is impossible to design a 'perfect test' that will objectively and effectively measure superannuation fund performance. In the absence of an ideal test, a refined version of the current test is likely to provide the best basis for ensuring that trustees are held to account for delivering the best financial outcomes for members (Option 1 in the Consultation Paper).

We do not believe that any of the alternative approaches proposed in the consultation paper represent an improvement compared to the current test, and that moving to a different metric or combination of metrics would add complexity and potentially exacerbate unintended consequences.

Stability of the test framework and consistency in the application of it are necessary for consumers to be able to assess whether their funds are working in their best financial interests. Moving targets and too many carve outs or exceptions will impede consumers' ability to assess whether they are getting the best returns possible.

However, we believe there are opportunities to improve aspects of the test framework while honouring the four principles described in the consultation paper.

That the current test assesses implementation of the investment strategy rather the appropriateness of the strategy is not necessarily a negative. However, it means that the test is an incomplete measure of delivery to member outcomes. This needs to be considered when thinking about extending the coverage of the test to certain segments. For example:

- **Retirement** - where the objectives are more nuanced as recognised in the Retirement Income Covenant.
- **Single asset class options** - which tend to be used more frequently as part of an overall portfolio where testing the individual components is likely to be less informative.

Generally, the less diversified an option is, the greater the potential mismatch to the benchmarks used in the test and the higher the likelihood of failure, even where the fund may be fulfilling a specific role and is achieving its stated objectives.

While this submission briefly discusses our recommendations for the performance test, we appreciate there are a range of diverse views on how best to achieve the ultimate objective. We look forward to = = further consultation on how the test framework can strike the balance of being flexible enough to allow funds to pursue the best possible returns for their members, without compromising the test principles of being widely applicable, transparent, enduring and simple.

About Aware Super

Meet Aware Super - the multi-awarded super fund. We're here to help our members grow their savings, whether retirement is 2 or 20 years away. As one of Australia's largest profit-for-members funds, we always remember whose money it is and whose future we're looking after.

That means being super helpful in ways our 1.1m members want, and sometimes in ways they don't expect. From super returns of 8.40% p.a.*[1] over ten years for our High Growth option. To expert super advice and guidance for right now. We're committed to helping our members get more from their super, so they can get more for their future.

Summary of recommendations

1. That the draft guiding principles of the test framework include 'simplicity' as a principle.
2. That it be clarified the draft guiding principle of 'enduring' does not mean *unchanging*.
3. Assess benchmark suitability according to the following principles: forward-looking, representative, transparent, accessible and, ideally, investable.
4. Regularly monitor the suitability of indices through, for example, a working group of technical experts including from industry.
5. Weight lifecycle stages by time, rather than FUM, to provide a clearer picture of actual member outcomes.
6. Provide clear information about insurance for individuals considering switching funds.
7. Provide APRA the discretion to consider the context of a product's failure of the performance test and apply consequences proportionately.
8. Ensure communications relating to product underperformance can be appropriately tailored to the circumstances of a product's failure and next steps, including where an SFT is imminent.
9. Do not extend the accumulation performance test to retirement products.

[1] Index median of 7.89% p.a. for the same period. Source: SuperRatings Fund Crediting Rate Survey (FCRS) 31 December 2023 (SR50 Growth (77-90) Index (approx. 50 options). Returns are after investment fees and costs, transaction costs, tax on investment income and any implicit admin fees. Past performance is not an indicator of future performance.

Detailed recommendations

Clarify the guiding principles

Aware Super supports the four guiding principles outlined in the Consultation Paper.

We recommend the addition of 'simplicity' as an additional principle. Given the significant consequences of failing the test, a trustee should be able to as easily as possible measure how much active risk they are taking against the test in developing strategies to deliver member outcomes. A complex test makes it much more difficult for trustees to appropriately assess this risk and address it if required.

We also recommend clarifying that the draft guiding principle of 'enduring' does not mean *unchanging*. The test must evolve over time as new asset classes and benchmarks are developed, although changes to these benchmarks must only be applied on a go forward basis.

Recommendations

1. Include 'simplicity' in the guiding principles of the test framework.
2. Clarify that the draft guiding principle of 'enduring' does not mean *unchanging*.

Ensure the test remains fit-for-purpose

Setting benchmarks

Looking at the current set of asset class benchmarks we find that the Unlisted Infrastructure and International Unlisted Property benchmarks are problematic due to their "unfrozen" status impacting on transparency, and the possibility of retrospective changes to returns as new funds are added to the index.

We recommend a set of principles be applied to assess current and potential future benchmarks for inclusion. A benchmark should be:

1. **Forward-looking** and not applied retrospectively
2. **Representative** of the asset class it applies to
3. **Transparent** so that trustees can understand the composition of the benchmark
4. **Accessible** in terms of being widely available at low cost
5. **Investable** where possible, noting that this is likely not possible for unlisted asset benchmarks

Monitoring indices

Regularly monitoring the suitability of indices is needed to enable the test to evolve over time. This could be involve, for example, a working group of technical experts which includes industry representatives. This would ensure the test can mature in line with innovation in the industry as new asset classes and strategies are deployed and would allow better indices to be developed in line with the principles above.

Recommendations

3. Assess benchmark suitability according to the following principles: forward-looking, representative, transparent, accessible and, ideally, investable.
4. Create a working group of technical experts, including industry representatives, to regularly monitor the suitability of indices.

Simplify for consumers wherever possible

Weighting of lifecycle stages

As we highlighted in our October 2022 submission on the Your Future, Your Super Review, the current approach of weighting lifecycle strategies by funds under management in each stage could lead to different test outcomes depending on whether a fund has a younger or older demographic profile. We believe it would be more appropriate to weight each stage based on the time a member will spend in that stage.

Informing choice

It is important that communication to members about their superannuation product failing the performance test provides them the information they need to make a decision about the right action to take. Otherwise, members risk being worse off.

For example, switching funds could impact on members' existing insurance coverage. It is important that this information is presented to members in any communication involving a recommendation to switch funds.

While insurance is mentioned multiple times in the current version of the letter sent to members of underperforming funds, there is no information provided about exactly what members should consider in relation to their insurance coverage. Given some MySuper members may not even realise they have insurance, the implications for cover should be set out clearly in the letter.

Recommendations

5. Weight lifecycle stages by time, rather than FUM, to provide a clearer picture of actual member outcomes.
6. Provide clear information about insurance for individuals considering switching funds.

Introduce the concept of proportionality

A robust, tailored approach to failing the test

In line with our October 2022 submission on the Your Future, Your Super Review, we believe that APRA should be provided with discretion to consider the context of a product's failure of the test and apply consequences proportionately.

For clarity, this is not a proposal to 'water down' the test or its consequences for poor performers.

There is a material risk for even well performing funds that they will fail the test eventually through random chance, simply as a result of taking active risk. A trustee with a product that has failed the test should have the opportunity to provide additional information to APRA, either before the test or within a reasonable timeframe, to inform APRA's response.

Considerations which could be taken into account when considering the appropriate regulator response to a failed test include:

- Whether the product has previously failed;
- The quantum of failure beyond the 50bp p.a. threshold;
- The headline returns of the product;
- The reason for the failure – for example, in situations where:
  - A benchmark mismatch may cause a failure that may not otherwise have occurred (and may cause multiple failures);

- An investment strategy should be measured against an alternative benchmark;
- A risk management overlay or other strategy that can be shown to be appropriate for a product's membership has caused underperformance;

- Whether the trustee can sufficiently demonstrate that issues with investment strategy leading to the failure have been corrected and performance going forward will not be impacted.

These additional factors should be robustly assessed by APRA though examination of evidence provided by funds.

In the case of Socially Conscious Investment options for example this may involve the trustee demonstrating the contribution to underperformance coming from exclusions to the investment universe outlined in the product disclosure statement.

A focus on member outcomes

Importantly, this approach should not create a system where failures of the primary test are not acknowledged or addressed.

However, creating clear approaches to managing consequences for failure in different circumstances will help ensure that products which are delivering good member outcomes are not treated unfairly. This will ensure the assessment process can provide proportionality in response to failure, without removing the "bright line" assessment approach.

While the original consequences for failure (informing members and closure of the fund to new members) should be maintained where these are appropriate, APRA should have the discretion to apply alternative consequences or moderate consequences where they may not be appropriate.

For example, if a fund can demonstrate that current member outcomes have improved and issues causing failure are historical, APRA should have the discretion to allow products to remain open following a second failure.

To further illustrate, it may be appropriate to amend member communications or, in circumstances such as where a merger is already underway for a failing product, it would be appropriate to provide exemptions from sending the regulated member letter.

Recommendations

7. Provide APRA the discretion to consider the context of a product's failure of the performance test and apply consequences proportionately.
8. Ensure communications relating to product underperformance can be appropriately tailored to the circumstances of a product's failure and next steps, including where an SFT is imminent.

Limit the application of the performance test

The performance test is not appropriate for retirement products

Aware Super does not support the extension of the performance test to retirement products. While investment performance is one element of the performance of retirement products, it should not be tested in isolation.

The current test, with its singular focus on investment returns, cannot appropriately measure the performance of retirement products, including innovative retirement income streams, for several reasons:

- Applying the current test would directly conflict with the responsibility of trustees under the Retirement Income Covenant to balance the three key objectives of income, risk and access to funds – i.e., it would not reflect the needs of members.

- Retirement solutions are also likely to involve multiple products, and it wouldn't be appropriate to test these building-block products independently of each other.
- The test does not directly consider investment risk, and hence cannot measure the success of products designed to manage/balance investment risk (including sequencing risk).

Applying a test focused solely on fees and returns would not provide a useful measure of success and could send the message that these are the only factors members should consider when choosing retirement solutions.

Recommendation

9. Do not extend the accumulation performance test to retirement products.