Annual Superannuation Performance Test - Design Options

SuperRatings' Submission

April 2024

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1. Executive Summary

SuperRatings would like to thank Treasury for providing us with the opportunity to deliver this submission in response to the Annual Superannuation Performance Test – design options consultation paper, which seeks feedback and comments on options to improve the sophistication of the Annual Superannuation Performance Test and specific questions raised in the paper issued 8 March 2024.

SuperRatings is a research and ratings firm, which has been assessing and rating superannuation funds for more than 20 years. Given SuperRatings' background in superannuation, we are well placed to provide input on a number of questions posed by the consultation. Due to the significance of the test on member outcomes and the industry itself, we have also engaged with peers during this process as we feel it is imperative that there is an appropriate test mechanism that is well-aligned to improving long term member outcomes, supports innovation within appropriate guardrails and builds upon the benefits realised from the initial test to date.

There is no perfect solution to many of the queries raised, rather we are focused on the guardrails that exist for the industry, which encourage appropriate levels of innovation and competition, while always being aligned to end member outcomes. We believe the current design of the test is inhibiting this. We see funds' approaches rapidly converging, which has reduced negative outliers in market, but we now believe the marginal benefits of the current framework are reduced. The testing framework can be improved and should be broader than an implementation test. Broadly, we wish to ensure a member outcome lens is central to the approach.

Overall portfolio performance is key to overall member outcomes. Our key learnings over time are that there is often some level of gaming to assessments, which cannot be fully avoided. However, if appropriately specified, the time spent trying to do this by any provider is largely futile if the marginal benefit of this is low.

Differences in approaches by funds to portfolio construction have been strong drivers of member outcomes over the past 20 years. This should be supported where appropriate, and this can be done in a manner that harnesses the benefits of the test realised around data and systems to date.

Overall, we would support a three-metric approach (Treasury option 3b) with a requirement to pass the majority of the metrics. The Conexus Institute recently held informal discussions with representatives of the asset consulting and research house communities to garner opinions on the Your-Future-Your-Super (YFYS) performance test ('the test'). The aim was to see if broad consensus could be reached around how the test should be redesigned. Please refer to the analysis they have provided and hopefully it mirrors sentiment in the industry for key groups who are tasked with assessing fund performance.

For clarity, based on engagement with the industry, we would be supportive of an approach that included assessment based on the following metrics:

(a) **Risk-adjusted returns relative to a simple reference portfolio (SRP)** – This is Treasury's option 2c.
(b) **Peer comparisons of risk-adjusted returns** – This is Treasury's option 2b.
(c) **Current test** – Retaining the current test would maintain some continuity and aid transition.

We hope this exemplifies the approach and spirit embraced by those involved and that it is a net positive for the industry that a workable and consistent approach can be found. There will not necessarily be a perfect solution, but there is a solution that adds a net benefit to super fund members that should be sought.

Once again, SuperRatings would like to thank Treasury for the opportunity to prepare a submission to this consultation. Feel free to contact any of the following should you have any questions or require further information:

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2. About SuperRatings

SuperRatings is an independently owned superannuation research company providing data analysis, analytics and insights services and product benchmarking to the superannuation industry. SuperRatings prides itself on providing impartial services to our clients and their members, therefore our ratings methodology includes all superannuation funds, and we limit the ratings percentile bands of funds to ensure our assessment remains independent. We actively promote engagement, education and ownership of superannuation through the provision of:

- Research Analysis;
- Ratings;
- Insights Services;
- Product Reviews;
- Benchmarking; and
- Opinion.

Since its inception, SuperRatings has comprehensively reviewed hundreds of Australia's largest superannuation funds and service providers. SuperRatings currently maintains detailed information in respect of 400 superannuation products, incorporating MySuper, Choice and Pension products.

We believe we offer the most extensive industry coverage accounting for over $1.35 trillion in funds under management and 22 million member accounts. This allows us to understand the various costs, fees, products, services and performance of superannuation funds and benchmark these against the broader market.

3. Responses to Select Consultation Questions

3.1. Options for Reform

Question 1: Do you agree with these principles? Are there any other principles that should be considered?

SuperRatings broadly agrees with the principles proposed and is supportive of an improved focus on long term member outcomes through the test. The only additional aspect we would consider is that the test (via any focus on administration fees which we feel should be considered but can be considered via net returns) has an appropriate mechanism to have regard for the current landscape in administration and to ensure that funds have an ability to fund appropriate investment (supported by business cases that add to member outcomes) in systems, processes and capabilities. At present, the test has helped to effectively reduce administration fees but has no regard for service quality.

3.2. Design Options

Question 2. Is assessing the implementation of a strategy, as opposed to assessing the choice of strategy itself, a strength or weakness of the current framework?

SuperRatings believes it is both a strength and weakness of the current framework. Funds have gained a better understanding of the drivers of fund outcomes and uplifted data capabilities and reporting that have added a benefit to the industry. However, the specification of the test has made longer-term thinking subservient to short term necessity to be able to adapt to the test for a number of funds. An improved framework would uplift the value of member outcomes from the test while maintaining the data and system benefits harnessed to date.

Question 4 & 6. How should the test cater for new asset classes in the future?

Questions 4 and 6 are addressed in tandem. Directionally, we strongly believe that a test should provide appropriate guardrails for the industry and a framework that supports innovation where appropriate and are accretive to member outcomes. We would note the work done on growth/defensive frameworks by the Conexus Institute as a good starting point to consider to enable a better industry standard and consistency.

3.3. Alternative single-metric test – Risk-adjusted returns

Question 9. Would the Sharpe ratio be a more appropriate testing approach than the current framework? Would this lead to better member outcomes?

We do not believe CPI-plus, Sharpe ratios or the APRA heatmap would provide a better framework for the test.

3.4. Multi-metric test

Question 15. Would greater alignment to the APRA heatmaps improve the sophistication of the test?

Overall, we would support a three-metric approach (Treasury option 3b) with a requirement to pass the majority of the metrics.

Question 21. Would this framework improve the sophistication of the test? Would it reduce incentives to hug benchmarks and improve member outcomes?

Overall, we would support a three-metric approach (Treasury option 3b) with a requirement to pass the majority of the metrics. The Conexus Institute recently held informal discussions with representatives of the asset consulting and research house communities to garner opinions on the Your-Future-Your-Super (YFYS) performance test ('the test'). The aim was to see if broad consensus could be reached around how the test should be redesigned. Please refer to the analysis they have provided and hopefully it mirrors sentiment in the industry for key groups who are tasked with assessing fund performance.

For clarity, based on engagement with the industry, we would be supportive of an approach that included assessment based on the following metrics:

(d) **Risk-adjusted returns relative to a simple reference portfolio (SRP)** – This is Treasury's option 2c.
(e) **Peer comparisons of risk-adjusted returns** – This is Treasury's option 2b.
(f) **Current test** – Retaining the current test would maintain some continuity and aid transition.

We hope this exemplifies the approach and spirit embraced by those involved and that it is a net positive for the industry that a workable and consistent approach can be found for the industry. There will not necessarily be a perfect solution, but there is a solution that adds a net benefit to super fund members that should be sought.

Question 22. Would this approach be more, or less, favourable than the heatmap approach?

We believe the three-metric approach has the best overall chance of achieving the best overall outcome.

3.5. Scope of the test

Question 29. What are the most important considerations for performance of retirement products?

The considerations for performance of retirement products would encompass a range of factors that expand beyond pure investment performance. This would need to encompass other factors tied to income level and certainty. The current accumulation test has been unworkable for the majority of retirement or income focused products in market, with a number of retirement options for pre-retirees being removed from market as a consequence of the current test. If an option was an accumulation choice option and failed the test and was offered to retirees, the suitability of this option should be called into question but should require some level of qualitative overlay to be performed as there is a risk that some solutions are eminently sensible for key cohorts of retirees or risk averse members.

3.6 Fees

Question 36 & 38. How should fees be measured under each design option?

SuperRatings believes that the current measuring of administration fees within returns for the performance test is workable. The approach to separate sample sets for MySuper, Choice and Platform products appears reasonable. However, reviewing appropriate account balances is necessary for each cohort as they are expected to see variance. For platform products, a $50,000 account balance is often below the minimum balance threshold to join and is not well specified against the way in which these products need to be designed to compete.

Question 39. Is a peer comparison of fees the best way to measure fees? Is there a better approach to benchmarking fees? If so, how should this work?

We believe this approach is appropriate for a sample set of broadly comparable products. It should mean that for a given level of fees, providers are then able to compete to optimise the efficiency of their solutions with an appropriate range of features to optimise outcomes for their members and clients.

Question 40. What product cohorts should be considered? How should different cohorts be defined where products could meet multiple cohort definitions, such as single-sector retirement products?

This may mean some level of qualitative overlay is required. If the same underlying solution fails in one area of the market, it should be considered in each of the places where it is offered.

Question 41. How many years of fees data is appropriate to test? Should a greater weighting be given to certain years?

The current approach that focuses on most recent fees has simplified the test and improved alignment with member outcomes. It means that funds have been able to have a faster and more direct impact on member outcomes by benefitting from quickly changing fee structures for the direct benefit of their members.

3.7 Consequences

Question 42. How should the consequences be amended to better account for edge cases or different cohorts that fail the test for reasons beyond the trustee's control?

The testing regime would benefit from some level of qualitative overlay that can be applied by the regulator. There have been clear cases where the test has resulted in extremely adverse outcomes due to edge cases and this would have benefited from greater discretion. This is a small sample set of funds that would be impacted. An approach with broader coverage of the market with some discretion is better than a test with narrow coverage and no discretion. The latter lacks alignment to the market over time and will result in an incentive to move members/clients outside the purview of the test towards less scrutinised products.

3.8 Barriers to consolidation

Question 47. Are there any key barriers to consolidating closed and underperforming products? What quantitative evidence is there of these barriers? How do these weigh against other reasons a person may choose to remain in a product?

A key area that we believe requires greater attention is the fact that there may be agency relationships that are not simply reconciled against the test. With the significant attrition of advisers in the industry, coupled with significant numbers of previously advised clients, there needs to be far greater clarity around a workable solution for those previously advised clients who are now in a product that fails the test. Potentially having a previously advised client stranded in an underperforming product and facing the need for further advice triggered by a test failure cannot be the optimal solution. For licensees and advisers, there needs to be a workable client-centric solution that enables members to be cost-effectively moved to a substitute solution that better meets the requirements of the test.