



ANNUAL SUPERANNUATION PERFORMANCE TEST – DESIGN OPTIONS CONSULTATION PAPER

Rest Super Submission
19 April 2024

Executive Summary

- Rest supports the continuation of performance testing, while improving the sophistication of the test.
- The current performance test focusses on measuring implementation of an investment strategy, rather than accounting for asset allocation and option design. It can also disincentivise investments in emerging asset classes.
- Rest supports the creation of new additional benchmarks within the current performance test framework which cater for emerging areas including the energy transition, decarbonisation and affordable housing.
- Rest also supports the incorporation of an additional metric to reflect member outcomes, as a second step in the test. Ideally, this would be a qualitative assessment by APRA, which may include considering if investments in emerging asset classes are contributing to the overall outcome experienced by the member. It may also consider whether member investment outcomes were consistent with the member investment promise.
- Alternatively, if the second step is to be quantitative, out of the options in the consultation paper, Rest supports Option 2(c). Risk-adjusted returns relative to a simple reference portfolio (SRP) frontier has the benefit of providing members with a better assessment of the value delivered by their super fund's investment decisions.
- While consideration is being given to these broader reforms, there are simple improvements which could be made to improve the accuracy of the test in relation to the way administration fees are treated. This includes that administration fees, represented by actual and benchmark RAFF, should be calculated on the historic year against the same year of investment performance, to better represent historical net performance.
- While we are supportive of a performance filter being applied to retirement products, this issue should be considered holistically with the broader options for improvement to the retirement phase being considered by Government. Further, we welcome consideration of low carbon and/or sustainable benchmarks that are better suited to sustainable choice options, as part of the Government's broader work on the Sustainable Finance Strategy.

Background

Rest values the opportunity to provide a submission to Treasury's consultation paper, *Annual Superannuation Performance Test – Design Options*. Rest supports the aim of improving the sophistication of the Annual Superannuation Performance Test ("the performance test").

Rest is one of Australia's largest profit-to-member industry superannuation funds with nearly two million members – or around one-in-seven working Australians – that manages assets of around \$80 billion¹. We represent around one million members under the age of 30, who are decades from retirement. Many of our members work in part-time or casual jobs and tend to have lower balances by the time they reach retirement.

Ensuring we protect members' savings is core to our investment philosophy, and why low fees are imperative. To achieve our mission, we are committed to delivering strong, long-term investment returns, low fees, flexible and affordable insurance, and leading digital customer service and advice to help members engage with their retirement savings.

We put our members needs at the centre of everything we do, and we are deeply committed to maximising the retirement outcomes of our members.

Rest has long supported the policy objective of the performance test to ensure that only high performing funds manage superannuation for Australians, and that there are clear expectations for superannuation fund performance, and consequences for funds that persistently underperform.

Principles for Reform

Rest supports a principles-based approach to consideration of the performance test, and options for reform.

First and foremost, the guiding principle for the consideration of improvements to the performance test should be what is best for members. Rest therefore broadly support the high-level principles for consideration of potential reform outlined in the consultation paper, including "improving member outcomes".

We would also suggest consideration of an additional principle of "simplicity". We consider it is important that any performance test is as simple as possible for members to understand and use.

Design Options

The consultation paper put forward provides a number of options to start the conversation of improvements to the test, and we understand from Treasury that any proposed changes to the test would be the subject of further, more detailed consultation, to ensure the policy intent of changes is met and there are no unintended consequences.

Noting the preliminary stage of consultation and consideration of potential changes, we provide some high-level views on issues with the current test and options for improvements.

At the same time, we encourage the continuation of the conversation through more detailed modelling and understanding of an evidence base for reform, while at the same time working to clarify and clearly define the purpose of the performance test moving forward. This continuation of work should also consider the Government's Sustainable Finance Strategy and the emergence of the development and disclosure of climate transition plans. While this work is being undertaken, we

¹ As at 31 December 2023.

consider there to be an opportunity for some more simple changes to improve the accuracy of the test in the interim (see below under “Fees”).

At a high-level, Rest’s views are:

- We agree that a clear weakness of the current performance test framework is its focus on measuring *implementation* of an investment strategy, rather than taking into account the value provided by trustees through asset allocation and option design.
- We agree that the current test is not sector neutral and investments in emerging asset classes can be disincentivised through their lack of representation in traditional indices. This can have the effect of encouraging short-term decision-making. This is discussed further below in relation to consideration of additional benchmarks within the test.
- There is merit in consideration of an additional metric to be added to the current framework which better captures member outcomes and the value received by members from the active investment decisions made by their super fund.
- Moving forward, as a general principle and as a matter of fairness, we consider that any substantial changes to the test and benchmarks should be prospective in nature (i.e. implemented on a ‘go forward basis’) and follow a staged and careful approach to implementation.
- We consider there are some more simple improvements which could be made to improve the accuracy of the test insofar as administration fees are treated.

Consideration of additional benchmarks within test

Rest supports investing in areas which provide strong risk-adjusted returns, but can also contribute to the quality of the world our members retire into.

However, the current structure of the performance test can inhibit such investments, as benchmark and consequent outcomes may not be aligned to the test’s expectation for a full market comparison. The existing benchmarks may therefore act as a disincentive to a greater degree of active investment in important sectors of the Australian economy such as the energy transition, affordable housing and agriculture/agribusiness, even where such investments are in the best financial interests of members.

Performance test benchmarks only consider returns against other assets within the individual benchmark, whereas members’ expected retirement outcomes are affected by both the risk and returns of investments in the fund’s investment strategy. The reliance on benchmarking against existing indices means that even a good long-term investment strategy may result in a failed test outcome where benchmarks are not representative of the investment strategy.

For example, the existing infrastructure benchmark is not an accurate reflection of the risk-adjusted return profile of renewable energy given these assets are only a small component of the index that comprises a large fossil fuel component. As a result, funds take on additional risk when they invest in these assets even where the risk-adjusted returns are expected to improve member outcomes. These benchmark mismatches may impact investment decisions, creating a disincentive that prevents funds from investing in assets that both support the energy transition while also being expected to provide strong risk-adjusted returns. The need to manage active risk against these indices also conflicts with funds’ obligation to consider climate risks as part of their investment strategy.

Similarly, the Australian Property index does not include any exposure to residential housing, creating a disincentive for funds that might otherwise incorporate these investments as part of a desirable long-run investment strategy for members.

Rest therefore supports new additional benchmarks within the current performance test framework which caters for emerging areas including the energy transition, decarbonisation and affordable housing.

The precise nature of the indices used for such a benchmark, or benchmarks, would be appropriately the subject of a dedicated process of consultation. It may be that it is appropriate for a number of additional benchmarks to be created, or alternatively and in keeping with a strong desire for simplicity wherever possible, there could be consideration of an additional “Alternative Real Assets” benchmark incorporating multiple types of investments where there are not yet established benchmark indices.

We also believe an additional metric should be incorporated to reflect member outcomes. The additional metric would consider whether investments in emerging asset classes are contributing to the overall outcome experienced by the member. This is dealt with in the next section.

Incorporation of an additional member-focussed metric

Rest believes there is merit in consideration of an additional metric, or test, to be added to the current framework which focusses on risk-adjusted returns and better measures the member experience in terms of absolute returns and the value received by members from the active investment decisions made by their super fund. This would be a second step to the current test framework.

Our preference would be for this metric to be qualitative in nature. We support an approach whereby APRA is empowered to consider the qualitative aspects of performance in the event that a fund has not passed the current performance test. This could enable, for example, consideration being given to a fund that has generated strong member outcomes consistent with their member investment promise despite the fund not exceeding the required test threshold.

Alternatively, if the measure is to be quantitative, out of the options under Option 2, we would favour Option 2(c) in the consultation paper. Risk-adjusted returns relative to a simple reference portfolio (SRP) frontier has the benefit providing members with a better assessment of the value delivered by their super fund’s investment decisions. Adding Option 2(c) as an additional element of the existing test would result in consideration being given to both the effectiveness of implementation and member outcomes. While Option 2(c) is our favoured option from Option 2 in the consultation paper, there would be benefit in further engagement on other potential metrics of member outcomes.

The consultation paper (at page 29) canvasses a hierarchical approach to steps within the performance test. There will be circumstances where the performance in a given year does not reflect the outcomes being produced for members, such as through risk-adjusted returns or other shorter-term anomalies concerning benchmarks. The addition of this second step within the test, under a hierarchical approach, would assist in overcoming the current known (and potential future) limitations with respect to performance test benchmarks.

Broader considerations for reform

Fees

Rest believes that the calculation of actual representative administration fees and expenses (“RAFE”) and a comparison to benchmark RAFE is an appropriate method, within the existing performance test framework, to represent costs for members. The primary objective for any fund in delivering to its members is the long-term net returns that build retirement savings over time. It is therefore not necessary to represent other product features in a performance test of this type.

However, we have previously advocated for two amendments to the treatment of actual and benchmark RAFE to more fairly provide a measure of long-term net returns, and reasonable comparison between fund performance. We believe these simple improvements are capable of being implemented relatively easily, and would improve the accuracy of the test.

Firstly, administration fees, represented by actual and benchmark RAFE, should be calculated on the historic year against the same year of investment performance, to better represent historical net performance. The current treatment of only the most recent RAFE being used to net against historic net returns is a distortion of the experience of any member in a fund. Including historic RAFE against the year of return will mean that funds that have reduced their fees over time will have this reflected in the net returns in each year, without having a distortion effect.

Secondly, the calculation of the benchmark RAFE should be amended to remove tailored, non-public offer MySuper products from the median fee comparison. These products are not representative of the broad experience of members in public offer MySuper products, as trustees are able to negotiate specific discounts based on negotiations with an employer. As such, they do not align to publicly available products, are only available to specific groups of employees, and distort the calculation of the benchmark RAFE. Alternatively, a methodology that appropriately weights the benchmark RAFE with reference to the membership of MySuper products may address this distortion.

Scope of the test

We note the consultation paper contemplates extension of the performance test beyond the current cohort of products, including to retirement phase products, however we agree with the Government's initial focus on improving the performance test in the accumulation phase.

Rest is supportive of a performance filter being introduced to retirement phase products, but consider that the current "one-size-fits-all" design of the performance test would not be appropriate for the retirement phase. Members in the retirement phase often have objectives that are additional to the return outcomes measured by the current performance test. Considerations such as stability of returns or managing longevity risk can require investment strategies that trade off investment returns. Extension of the current performance test to retirement is likely to result in trustees designing investment options that are unsuitable for retirees.

On that basis, and given the parallel Treasury consultation process concerning the retirement phase of superannuation, we would suggest consideration of an appropriate filter for retirement products should be looked at holistically together with the broader options for improvement to the retirement phase, and trustees' obligations under the Retirement Income Covenant.

Further, in considering the expanding market for sustainable investment products and the Government's Sustainable Finance Strategy Priority 4 (to develop a labelling system for investment products marketed as sustainable), we would also welcome consideration of low carbon and/or sustainable benchmarks that are better suited to sustainable choice options, and which often reflect member preferences.

Conclusion

Rest values the opportunity to engage in Treasury's consultation and provide this submission. We welcome the consultation as the start of the conversation about improvements to the sophistication of the performance test.

We would welcome the opportunity to further discuss any matters outlined in this submission at your convenience.