s 22

From: Spear, Luke
Sent: Thursday, 22 June 2023 4:43 PM
To: s 47F ; s 22
Cc: s 47F (Industry Super Funds - Unclassified); s 47F ; s 47E(d) ; s 22
Subject: RE: YFYS Review Meeting follow up [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

s 22 just sent you an email about the PT notification letter, but more broadly on the PT just wanted to say thanks for the call last week and your analysis on the current YFYS test.

As mentioned during the meeting although the framework of the current test has several shortcomings there was a practical limit to the changes that could have been completed in time for this year's test. It was also important to the Government a test was rolled into the Choice sector without further delay. Of course we are happy to take on board your views and analysis as we explore further updates to the test beyond the current framework.

Regarding the below, I note that as per the PC's recommendation the current performance test was created as an 'right to remain' in the super system, ie protecting members by removing the worst performing funds. I think with this objective in mind, the test has been successful (in the MySuper space at least). Of the 14 products that have failed the performance test; 11 of which have exited the market, two have since improved their performance and one product remains in the market but is closed to new members. The point about the potential of a test having broader objectives (ie not just improving overall performance by removing the worst performing ones) is valid, although as you note I expect we would have to look at changes to the framework of the test to achieve this.

Your analysis on the performance gap in short term net returns is interesting. Greater volatility in net returns during the past 2 years may of course have be driven by the greater than usual underlying market volatility in those years (pandemic, war etc etc), but in any event two years of data is a small sample to isolate the cause of an increased range of performance. As more data becomes available it will be interesting to consider whether this turns into a trend. On administration fees, these were chosen as a part of the test primarily because this is a fee mechanism that funds have direct control over and would have an immediate impact on members. Looking forward, I expect how fees are measured in the test will be something we look closely at as part of any future changes to framework.

s 22

cheers

luke

Luke Spear — **Assistant Secretary**
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From: s 47F [redacted]@industrysuper.com>
Sent: Thursday, 15 June 2023 5:01 PM
To: Spear, Luke <Luke.Spear@treasury.gov.au>; s 22 [redacted]@treasury.gov.au>
Cc: s 47F [redacted] (Industry Super Funds - Unclassified) s 47F [redacted] @industrysuper.com>; s 47F [redacted] @industrysuper.com>; s 47F [redacted] @industrysuper.com>
Subject: YFYS Review Meeting follow up

Hi Luke, thanks for you and the team's time yesterday to discuss ongoing review of the YFYS framework. Please forward this to s 22 [redacted] too.

While its still fresh in my mind I wanted to reinforce a few points and reiterate where we will come back to you with further analysis and info.

I've attached our performance assessment submission for reference. We invested a lot of time and resources internally to provide this submission please take the time to have another look. We have also included below the consequences of using differential BRAFE's and selecting median product rather than median member metrics.

Improvement in member outcomes:

- The attached submission considers empirically how the test may have impacted member outcomes:
  - There's no evidence it has lead to a reduction in the spread in performance between products (p6 fig 2);
  - While 40 products reduced fees the median fee reductions was just 15 bps (perhaps sufficient to evade test failure but insufficient to move a member from achieving poor outcomes to materially better ones)
  - Nor has the $ value of fee reductions $410m in 2022 exceeded the $ value of apparent net fee increases $558m (p 20)
- Combined with the absence of member initiated product switching following failure and tendency of failed products to merge with mediocre ones (certainly among retail funds) we think there needs to be a much stronger focus on translating the YFYS objectives into actual outcomes.

Contribution of fees to net return outcomes:

- The attached submission (at page 5 fig 1) deals with the contribution of fees to net return outcomes;
- The spread in administrative fees and expenses accounts for only 50bps difference in net return outcomes, compared to 100bps for total fees, 200bps for the benchmark SAA NIR and over 300bps for actual net return;
- Empirically there is no basis for the weight placed on admin fees and expenses in the test (or total fees for that matter or the comparison tool) given they contribute as little as one sixth and at most one third to actual net returns. Or to put it another way non-fee factors (ie the strategy and execution) contribute the vast majority (2/3rds) or performance outcomes;
- The PC identified there is persistence in outperformance and underperformance. We will provide further analysis following this year's performance tests to reinforce why net returns are a robust metric to inform fund selection.

BRAFE measurement:

- We have consistently pointed to the problems with using median product administrative fees/ expenses rather than fees that are actually representative of the median member;
- Statistical analysis utilising unweighted samples is flawed. In the case of product median fees it ascribes equal weight to products that have few members relative to those that have many it therefore fails to identify typical fees paid by members;
- The fact this metric was utilised in the original regs for MySuper assessment is not an adequate rationale for why it should continue – it results in a much weaker test – especially for choice products that have a long fee tail;
- Based on our analysis of the latest choice heatmap the difference between median product and median member RAFE's is 40bps vs 29bps – that's quite a concession to the high fee tail…
- The continued utilisation of single year ex-ante administrative fees is also flawed. Again, just because this was a feature of the inaugural Mysuper test does not make it an appropriate policy setting;

- Although you may not have been involved at the time it was not consulted on when the exposure draft regulations were originally released – on the contrary, the draft regulations envisaged the use of the full lookback period for administrative fees – in effect treating them in the same way as investment fees and costs.

s 22 [redacted]

Thanks for your time. We will be in touch.

s 47F [redacted]

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Industry Super Australia

Your Future, Your Super Review – Performance test methodology supplementary submission

Overview

The introduction of an annual performance assessment has brought important accountability to funds' trustees to ensure minimum performance outcomes are being met in respect to MySuper products.

The performance test regime represents a significant improvement over the self-assessed Member Outcomes regime that preceded it (even though it continues to operate in parallel).

Since its inception the test has identified 14 MySuper products that have failed which collectively managed $60 billion in assets for 1.1 million members.[1] This represents around 7% of total member savings and 8% of member accounts. Without the test these members would be none the wiser.

However, as detailed in ISA's initial submission, it is not obvious whether the outcomes of members in these products have materially improved given only 6% of members in underperforming products have left them and more than half of members remained in a product that failed twice – with the balance either merging into products that passed or trustees made changes to narrowly avoid a second fail.

ISA's initial submission estimated members of underperforming products lost $1.6 billion collectively in the year to June 2022 – even after accounting for fee reductions – relative to members in top performing products. In considering the operation of the performance test and impact on trustee behavior and, ultimately, member outcomes, ISA argues in this submission several shortcomings need to be addressed. These include:

- The transparent publication of data to ensure test outcomes can be properly evaluated and validated;
- The failure of the test to assess the trustee's strategy in addition to implementation;
- The failure of the test to appropriately assess the risk members actually experience in exchange for the net returns achieved over the duration of the test;

[1] APRA MySuper Performance Test 2021, APRA MySuper Performance Test 2022, APRA Quarterly MySuper Statistics (June 2022), APRA Annual MySuper Statistics (June 2021).

- The failure of the test to operate over a sufficiently long duration to properly assess member outcomes over multiple market cycles and not discourage investments in asset classes that have longer investment horizons;
- An inappropriate bias to the calibration of ex-ante administrative fees to avoid technical test failure rather than making trustees accountable for what they have actually delivered to members' accounts in after-fee after-tax net returns;
- A continued lack of neutrality in fee and cost disclosures required under ASIC Regulatory Guide 97 (RG 97), which results in different fee disclosures on similar underlying investments depending on how they are held and offered to members;
- Redesigning the test to eliminate gaming and re-orientating the test towards materially improving member outcomes, and presenting test outcomes in a way that is likely to lead to consumers making better decisions.

ISA makes seven specific recommendations to the performance test methodology to improve the integrity and robustness of the test. While ISA suggests material changes to the performance benchmark methodology are warranted, minor changes could be implemented as an initial step to improve outcomes before effecting more significant changes.

Summary of recommendations

1. APRA should publish product-level SAA domicile and hedging information to enable the performance test to be externally validated as well as publishing the Actual Asset Allocation (AAA) for all products and numerical performance test results.
2. All products should be assessed over at least 10 years or, if the product has operated for less than 10 years, for the life of the product.
3. The basis for RG 97 and related data collections utilised for performance testing should be reviewed to ensure fees and costs borne by members are treated consistently regardless of how products are offered to members (whether directly by a fund or via a platform) and how funds access underlying investments (directly or indirectly).
4. The performance test should be based on the product's RAFE for the duration of the test, and the BRAFE should be member-weighted rather than product-weighted.
5. Consideration should be given to replacing the existing product specific SAA benchmark with a simple naïve benchmark for all MySuper products comprising a simple low-cost diversified portfolio to assess whether trustees are adding value to members savings.
6. Coupled with a simplified transparent test any products that fail be subject to 'a show cause' and more granular assessment of the risk return trade-off for members.
7. APRA should publish dollar value estimates of value add (or loss) to members with a representative balance based on the compounded annual outcome of the performance test.

Contents

Performance test methodology

Key design features of the existing test

Before considering the methodology of the test in detail, it is important to outline its basic structure and operation. The existing test has the following core features:

- Each product is assessed against a benchmark particular to itself with reference to the historical Strategic Asset Allocation (SAA) of the product as determined by the trustee;
- SAA Benchmark portfolio returns for each product are calculated with reference to asset class matched market indices net of tax and efficient investment fees;
- Lifecycle products are assessed at the product level by aggregating the life stages weighted by investments in each life stage;
- Product and benchmark net investment returns are calculated over a duration of eight years and a minimum of five years;
- Reference administrative fees for the product are assessed independently of net returns over the previous 12 months rather than the full duration of the product;
- The benchmark reference administrative fee is the median of all products (not the median paid by members);
- A failure of the test is triggered when the product's 8 year net investment return falls more than 0.5% below the product's benchmark net investment return inclusive of an adjustment reflecting whether the product's most recent 12 months administrative fee is higher or lower than the product median.

Some of the important consequences of these design features are:

- The product tailored benchmarks net out the effect of differences in portfolio construction (portfolio strategy) between products – an important contributor to ultimate returns;
- The trustee sets and can manipulate the construction of the benchmark which their product is assessed against – potentially making the performance hurdle easier to achieve;
- The net returns obtained by members over the duration of the test are not measured or trustees held accountable for;
- The use of a 12 month administrative fee adjustment to net investment returns ascribes a higher weight to admin fee reductions than the rolling average impact of investment fee reductions and the effect of any trustee improvement to investment implementation, let alone strategy (which carries zero weight);
- The use of a median product administrative fee rather than median member fee results in a higher fee assumption for the benchmark than most members pay, resulting in an easier test;
- The duration of the test might be inadequate to assess trustees' actions over the course of more than one market or economic cycle;

- There is no explicit consideration of the *actual* risk taken by members in exchange for the returns they receive.

As we consider the test in detail it is important to understand what factors are captured or not by the test and their relative influence on ultimate member outcomes.

Conceptually this is very important because if the test overlooks important factors that contribute to member outcomes, then it won't discipline or incentivise trustees to address those factors.

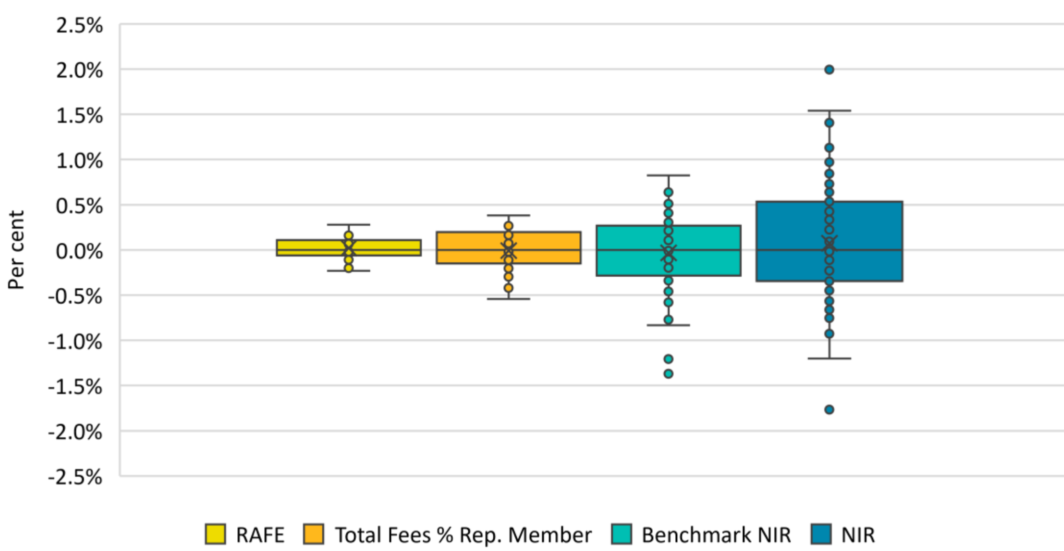
Factors contributing to net return differences

ISA has empirically assessed the potential scale and sources of performance improvement including fees, investment execution, strategy, and how they might contribute to realised net returns. Figure 1 below provides a representation of the relative size of these potential factors to the distribution or spread of net returns experienced by members.

As can be seen moving from left to right in figure 1, differences in administrative fees RAFE vary net returns by less than 0.5%, total fees vary net returns by 1.0%, the actual benchmark investment portfolio by around 2.0%, and observed net investment returns by more than 3.0%.

The spread between the best and worst observed net 8 year returns is almost 4.0% and the spread between the median net return is around 2.0% to the best and almost 2.0% to the worst net return.

Figure 1: ***Spread of factors affecting net return***
Year to June 2022



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual Superannuation Performance Test - 2022, APRA Quarterly Superannuation Performance Statistics (June 2022).

Given admin fee differences alone have only a modest bearing on net returns of MySuper products, the relative importance the test ascribes to the reference admin fee is curious. Moving a product from the highest to lowest fee could theoretically improve their test outcome by 0.5%, which is just a fraction of the 3.0% difference in the observed net investment returns.

A change in total fees could be more meaningful but at most could improve the test outcome by one third if sustained. Evidently more than two thirds of observed performance differences are due to factors other than fees, including the strategy (underlying asset allocation) and its execution – yet the existing performance test doesn't reward trustees for the portfolio asset allocation – which has the potential to have more than twice the impact of fee reductions.

Is the test improving member outcomes?

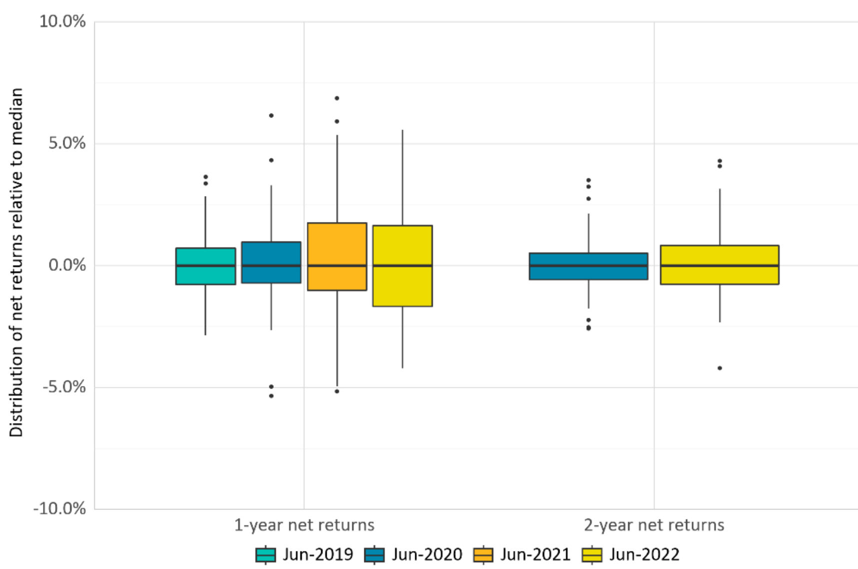
Before considering in detail the test methodology it is useful to assess after two rounds of the test whether the objective of the test is being achieved empirically.

Decomposing improved outcomes and attributing the drivers is a difficult task. However, the starting point is whether the operation of the test has caused poor performing products to 'lift their game'.

If this were the case, we would expect to see fee reductions and a greater focus on investment strategy and implementation result in a narrowing in the distribution or spread of net returns among products. Specifically, we might expect to see products in the bottom two quartiles begin to close the gap to median returns and observe a tighter distribution of below median returns. Figure 2 below shows the distribution of returns for the last four years – two years immediately preceding the inaugural Your Future Your Super (YFYS) performance test, and two years after.

Remarkably we see the return spread increase after the commencement of the test in each of the two years after the test compared to the two years before. This is the case for both below and above median returns. So rather than closing the gap in return outcomes we have at this early stage seen a widening in the performance gap between the poorest products, median products and top performing products.

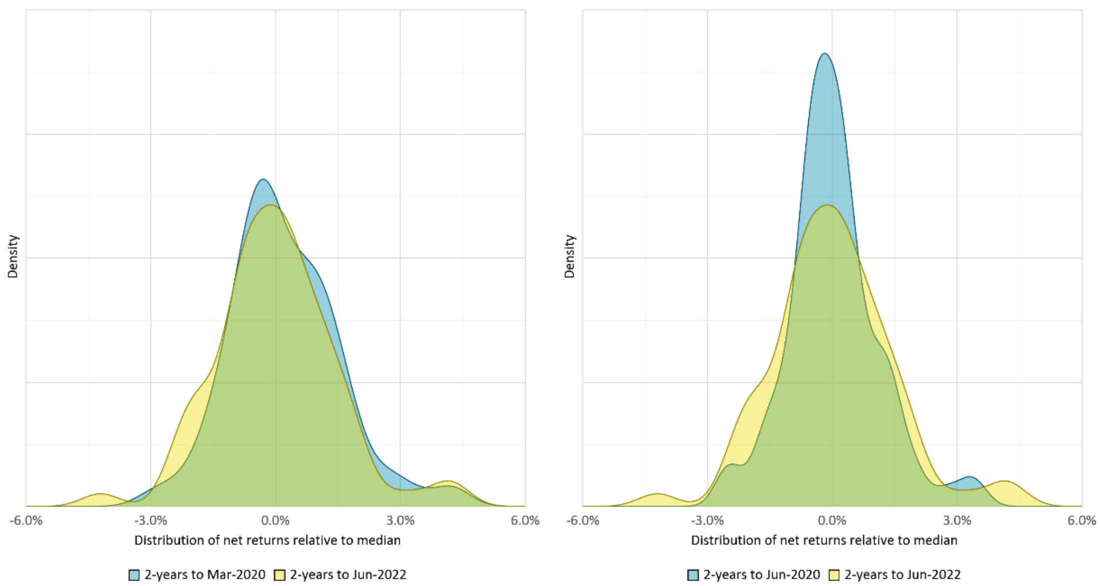
Figure 2: ***Distribution of product level net returns, 2019-2022***



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

It is possible this outcome is unrelated to the commencement of the performance test. For example, we might expect during abnormally good or poor investment return periods magnification of portfolio return differences. To assess this possibility, we examined rolling two-year returns at quarterly intervals and calculated average returns and product volatility. We then matched two periods before and after the test with similar average return outcomes and volatility. A density plot of similar periods before and after the test relative to the median is shown below (figure 3). As can be seen, the distribution and range of product returns has not narrowed since the introduction of the tests,[2] with a number of poor performing products achieving significantly lower returns relative to top performing products.

Figure 3: ***Density plot (distribution) of MySuper product two-year net returns***
Before and after the introduction of the YFYS performance test



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

Importantly these outcomes incorporate trustee responses to the performance test including fee reductions among products failing or close to failing the test. The nature of these fee reductions is discussed further later in this submission however it would appear they didn't materially close the net return gap.

The relationship between performance test outcomes and net returns

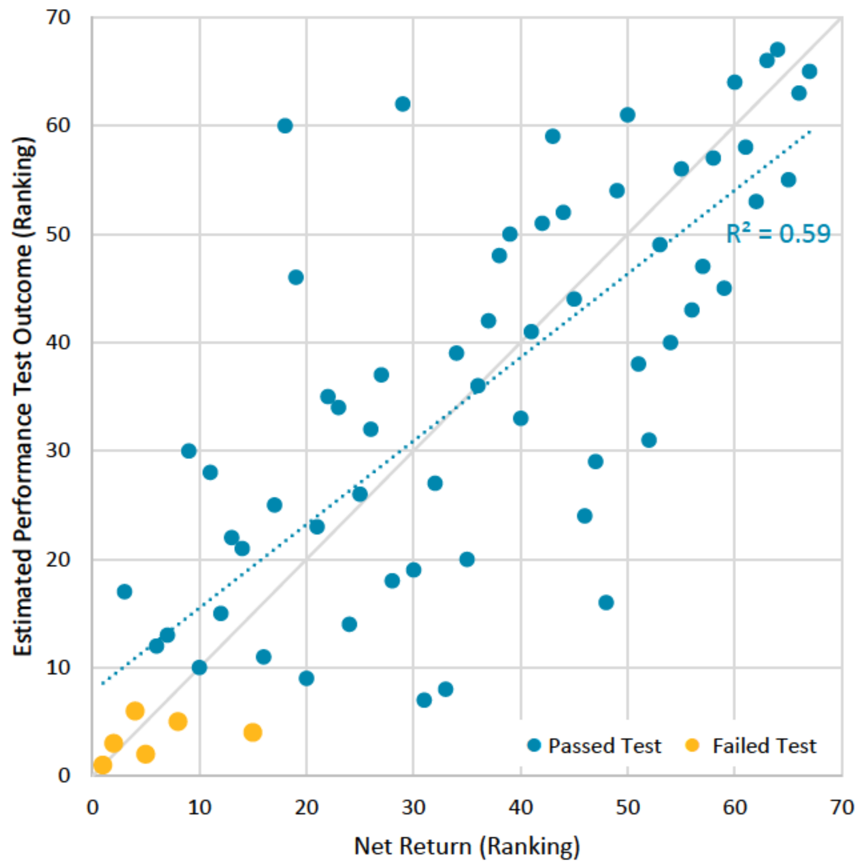
In considering whether the test is leading to an improvement in member outcomes (measured by net returns) it is worthwhile examining the strength of the relationship that exists between the performance test and net returns.

It is evident the test is identifying underperforming products. Figure 4 below shows the relationship between the test ranking and net returns. The products which failed the test (identified by red dots) also had poor net return rankings and so are clustered in the bottom left corner.

[2] In fact, we find evidence at the 5 per cent level of significance that variation in MySuper product net returns in the 2 years to June 2020 is lower than in the 2-year to June 2022.

However, the relationship between performance test outcomes and net returns is not directly linear. There are many outliers where either the product's performance test ranking is apparently adequate (despite the product ranking as poor or failing on a net return ranking), or the product has a relatively solid net return but poor performance test results.

Figure 4: ***Relationship between performance test rank and net return rank***



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual Superannuation Performance Test – 2022, APRA Quarterly Superannuation Performance Statistics (June 2022).

While on face value there appears to be a relationship between net returns delivered to members and performance test outcomes, it is much weaker than might be expected. A regression between the net return ranking and the performance test rank suggests only 59% of the performance test outcome can be explained by the actual returns delivered to members ($R^2 = 0.59$).

While the role of risk is discussed below, it is likely this relationship is not a causal one. Recalling that the performance test assesses the trustee's implementation of their strategy, it is plausible that trustees capable of implementing a strategy well are also likely to devise a quality strategy in the first place.

However, the absence of a more robust statistical relationship does raise issues around the design of the performance test and its potential failure to predict net return performance delivered to members, which is the key metric that will determine their final retirement savings.

Transparency and integrity

Empirical evaluation of the performance test to contribute constructively to this review was not a simple task due to a lack of transparency around performance test inputs and outcomes.

Since the inaugural test, APRA, has undertaken the performance assessments using product level data that is not contained in its statistical publications or otherwise publicly available.

Information on selected product-level strategic asset allocation domicile and hedging, while reported by funds to APRA, is not published, making it very difficult to validate the test results and assess its sensitivity to changes.

For ISA to evaluate the second round of the performance assessment we have sought this data directly from ISA member funds or have otherwise used sector level domicile and hedging information with a correction factor based on last year's performance test outcomes.

Seeking to replicate the latest test has been necessary as the regulator won't publish the 2022 numerical performance test outcomes other than a pass or fail until it releases its heatmaps later this year. As a consequence, this review is being conducted with only one out of two years performance test results in the public domain – which by any measure is unsatisfactory.

Other important data that would be useful for evaluating the integrity of the test is also not published, such as product-level actual asset allocations (AAA). The basis for doing so is discussed in the next section.

Until this information is transparently reported, ISA has concerns about the integrity of the performance test including the ways in which Strategic Asset Allocations (SAAs) might be manipulated by funds to pass the test.

Recommendation: APRA should publish product-level SAA domicile and hedging information to enable the performance test to be externally validated as well as publishing the Actual Asset Allocation (AAA) for all products and numerical performance test results.

Gaming of the SAA benchmark

As noted above, products are assessed against a product-tailored benchmark which references the SAA of the product and not the actual asset allocation of the product. Because the SAA is determined by the trustee and there is no specific obligation for it to reflect the actual asset allocation, there is the opportunity for the benchmark to be gamed.

In effect trustees can manipulate the SAA such that it could be reasonably expected to deliver a lower portfolio return than the AAA – in other words, the trustee can lower the hurdle return which they must clear.

It is not possible to independently determine the extent of such manipulation since APRA does not publish the AAA of products to assess how they might deviate from the SAA.

Nevertheless, there was a potential insight into such activity at the commencement of the performance test where a subset of MySuper products significantly revised their historical SAA (thus changing the benchmark portfolio they were assessed against).

Evidence of gaming

In the lead up to the first round of performance tests, 35 MySuper products revised their historical SAA benchmarks with most reducing exposure to 'Other' investments and increasing exposure to Cash and Fixed income (see figure 5).

The Other investments benchmark index has averaged 5.1% per annum over the 8 years to June 2022, compared to 1.8% per annum for Fixed income and 1.2% per annum for Cash, so this behaviour increased performance test outcomes by shifting the SAA to categories with lower returning benchmark indices.

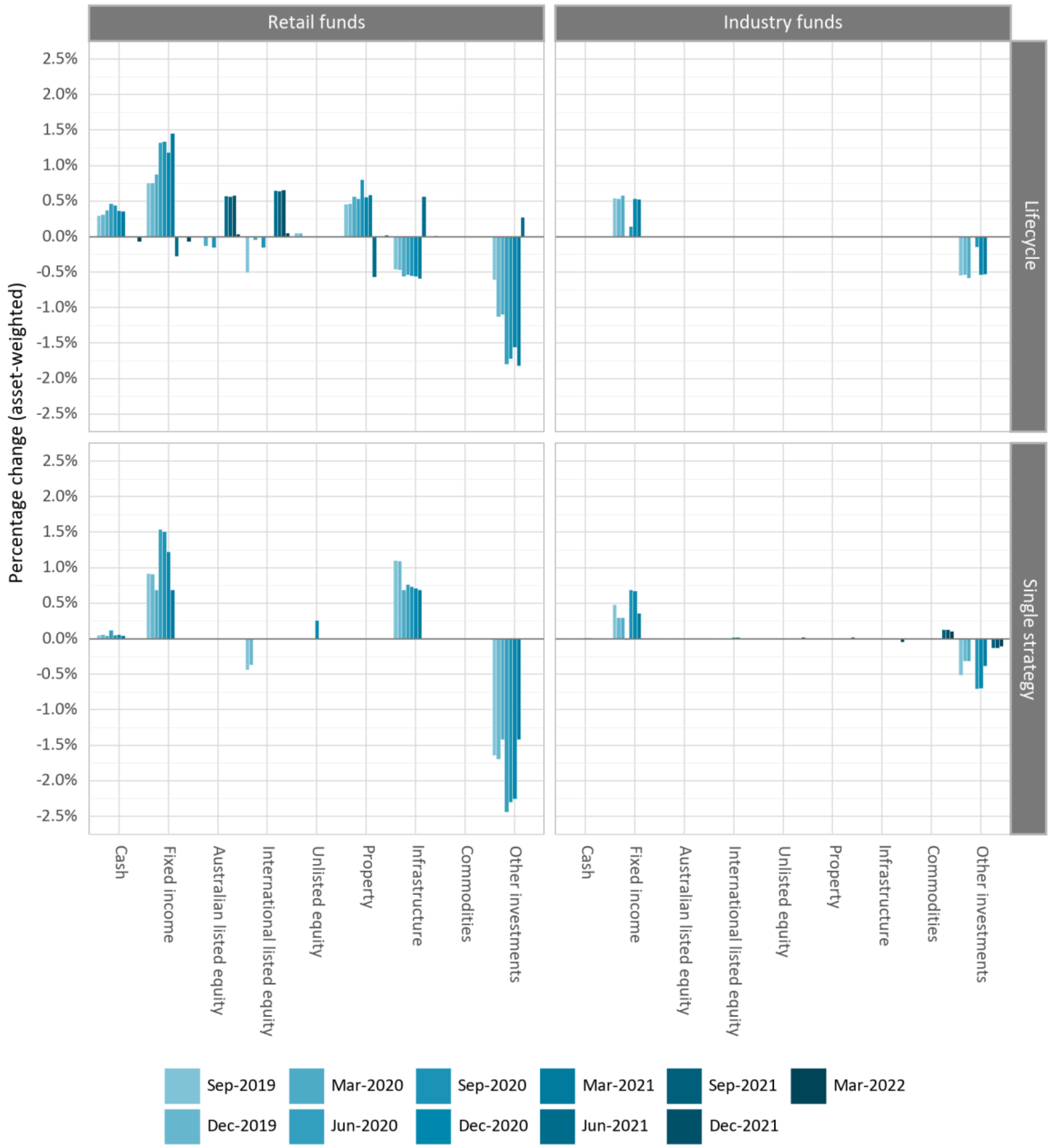
While there was in some instances a legitimate case for trustees to reallocate assets in the 'other' category to better reflect the underlying assets, there were surprising differences in the extent of this re-allocation across sectors.

The behaviour was particularly prevalent in the retail sector which accounted for 20 of the 35 product revisions. Revisions were more likely among lifecycle products and among these 84% of SAA revisions were from retail MySuper products. Furthermore, across both lifecycle and single strategy products the extent of reallocation (as a share of assets) was around three times greater magnitude among retail MySuper products than industry MySuper products.

The ability of funds to influence their product's benchmark returns via changes to their SAA opens the prospect of gaming within the system. In effect trustees can improve their performance test outcome not by increasing the performance of the product, but by lowering the bar to which the product is assessed against.

This reduces the efficacy of the performance tests and weakens their ability to improve member outcomes.

Figure 5: ***Revisions to SAA in the lead-up to performance tests***
Weighted average assets of all funds by sector



Source: ISA Analysis, APRA Quarterly MySuper Statistics (March 2021, June 2021, March 2022 & June 2022).

The duration of the test is too short

In general, products should be assessed over the longest time period possible to account for risk and market cycles, and to reflect that superannuation is a long-term investment.

Market and economic cycles and other regulatory guidance

ISA's analysis of the economic and financial market cycles in Australia shows that over the last few decades, financial market cycles have slightly shortened (to a median of 2.9 years over the period from 1984 and 2020) while economic cycles have substantially lengthened (to a median of 18.6 years from 1984 to 2020). Assessing performance over multiple market and ideally economic cycles allows for a better assessment of the resilience of investment portfolios, along with trustees' responses.

Additionally, the Conexus Institute found that using an 8-year period to assess returns will mean that for every six poor funds, the test will likely misidentify one as a good performer.[3] This reflects that over 8-year intervals, a poor fund may experience annualised performance above the threshold level. This is an unacceptably high risk of false positives.

Support for 10-year timeframe for assessing returns is also found on the Government's own Moneysmart website. The explanation given about how to choose investments uses a 10-year timeframe to show average returns.[4] Similarly, under the MySuper product dashboards legislation, funds are required to work out a return target for a period of ten years and the return for the previous ten financial years, or the period the product was offered.[5]

Discouraging investment in Venture Capital and early-stage Private Equity

The look-back period has important implications for portfolio construction and the inclusion of asset classes that are illiquid and have inherently long investment horizons. This is especially the case for Venture Capital (VC) and early-stage Private Equity investments. They commit capital in the very early stages of an enterprise many years before relevant products or services are ready for market with the expectation of valuations surging once positive cashflows and profits are attained. This lag (known as the 'j-curve') means the commitment period can be as long as 8-10 years for the specialist funds established for such investments. As a consequence, the existing lookback period may deter new allocations to VC thus distorting investment decisions and reducing the universe of assets that members are exposed to, reducing diversification and risk-adjusted returns.

Recommendation: All products should be assessed over at least 10 years or, if the product has operated for less than 10 years, for the life of the product.

Test fails to capture poor risk-return outcomes for members

A common criticism of the YFYS performance test is that it doesn't explicitly assess the risk members are exposed to in exchange for the returns they receive. Whether this is relevant for a relatively

[3] The Conexus Institute, *Working Version: Review of the Your Future Your Super Performance Test* (20 November 2020).

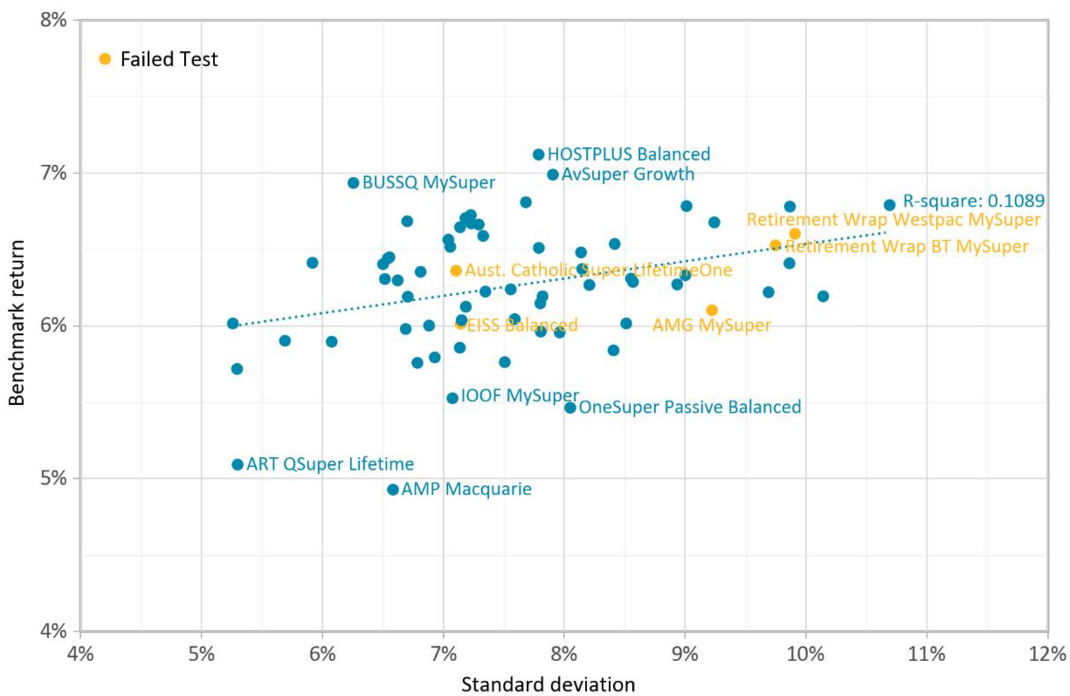
[4] Moneysmart, *Choose your investments* (accessed 14 October 2022).

[5] Division 2E of Part 7.9 of the *Corporations Regulations 2001*.

standardised product like MySuper is open to debate, but it is useful to examine in the context of the review and the efficacy of the test.

To some degree the performance test does attempt to take risk into account by constructing product-specific benchmarks that are matched to the supposed asset allocation of products. In theory, a product with a riskier asset allocation will have this reflected in the benchmark, thus attempting to control for risk in the performance assessment. In theory this makes some sense as figure 6 below shows. It reveals an expected (but not directly linear) relationship between the MySuper products benchmark returns and risk (measured by the volatility or standard deviation of returns).

Figure 6: ***Risk return of MySuper product benchmarks***
Eight years to June 2022



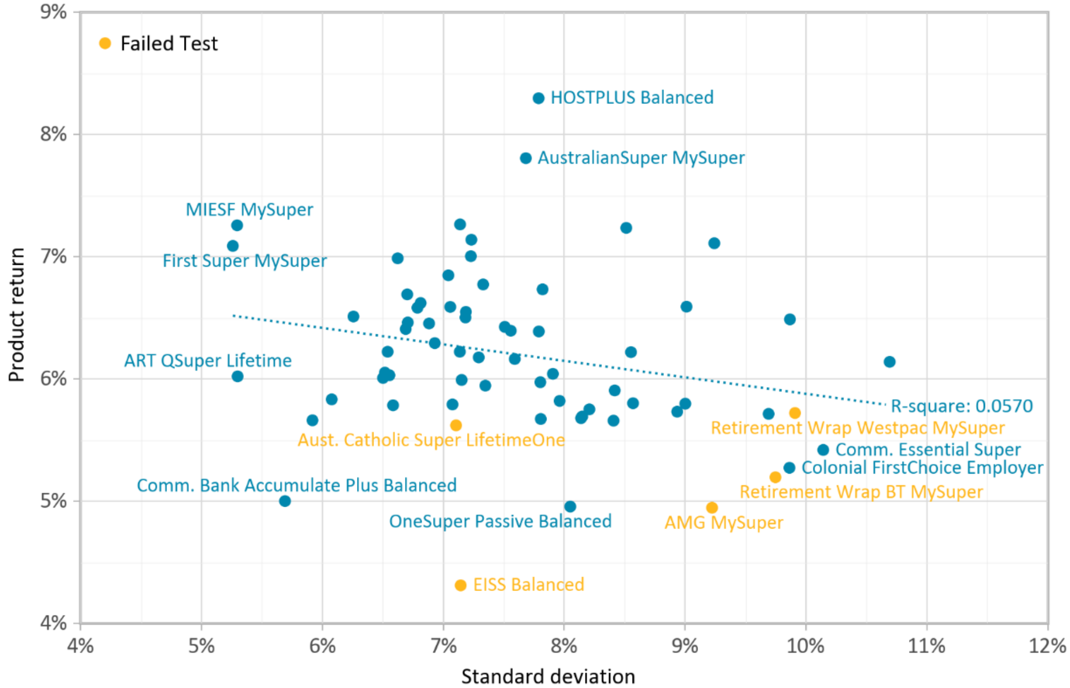
Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual Superannuation Performance Test – 2022, APRA Quarterly Superannuation Performance Statistics (June 2022).

There are two possible ways to interpret such results when comparing two products:

- Firstly, you can identify products with a similar return (y axis) and then assess which has delivered that return with the lowest risk horizontally (x-axis);
- Alternatively, you can identify products with similar risk (x-axis) and then assess which has delivered better returns in exchange for that risk vertically (y-axis).

However, what is more revealing is examining the actual (or realised) risk return of MySuper products, which is shown in figure 7 below.

Figure 7 – Observed risk return of MySuper Products 8 years to June 2022



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

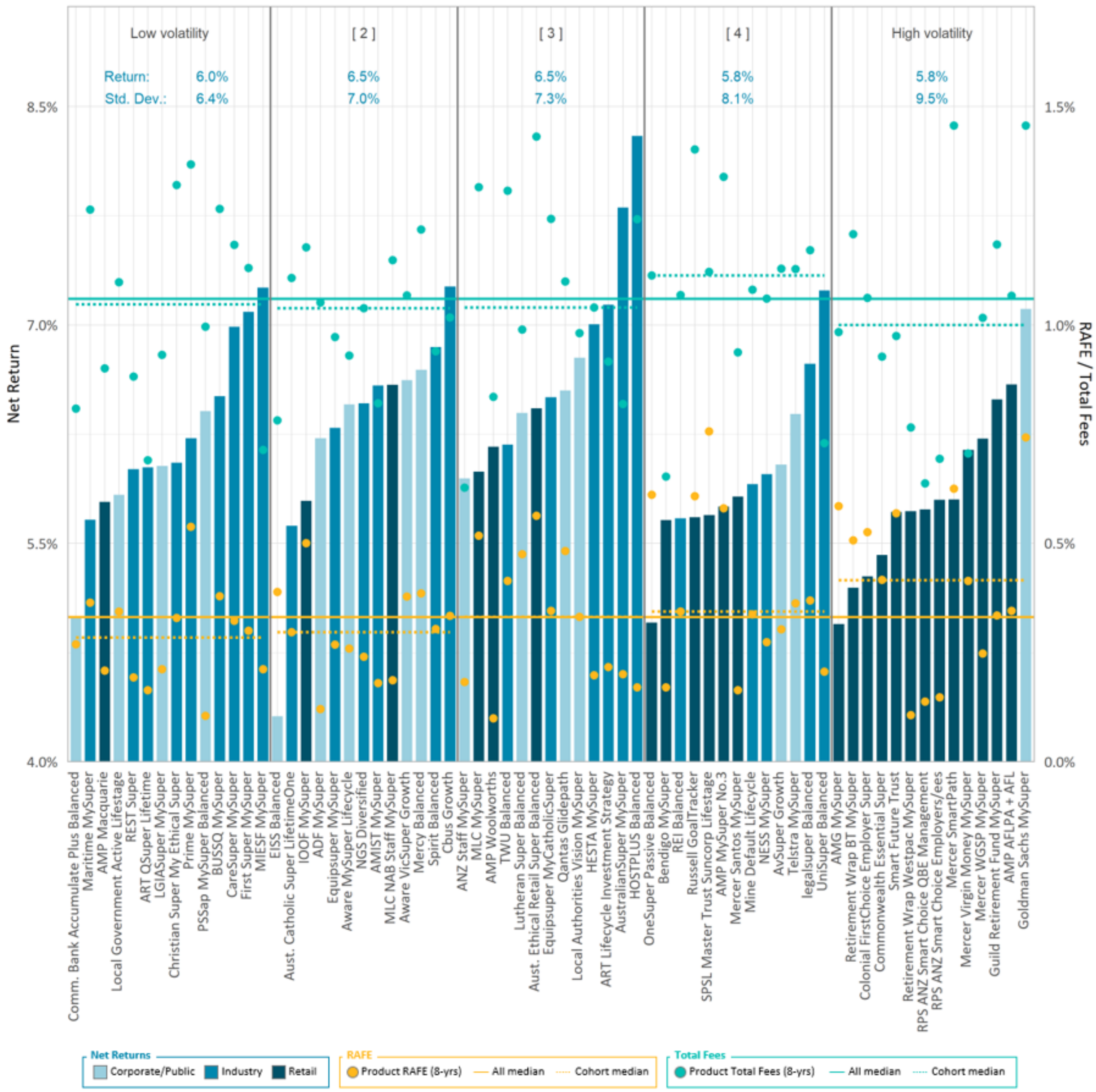
Evidently there are significant differences between the benchmark risk return outcome and the observed risk return outcome.

Specifically, the relationship for observed risk return outcomes is slightly negative because some of the poorest performing products are also the most volatile. This is very unusual and could be explained by three things.

- Firstly, the benchmark SAA for some of the products might not reflect riskiness of the investment portfolios employed.
- Secondly, it is possible asset selection decisions within the asset allocations are riskier and lower returning than the benchmarks.
- Thirdly, is that the fees for the products are significantly higher than the benchmarks resulting in returns being substantially lower despite exhibiting similar volatility to the benchmark.

To shed further light on the issue, figure 8 below quantiles the MySuper products by their observed volatility (least volatile to most volatile) whilst comparing their returns and fee levels.

Figure 8: MySuper product net returns and fees, ranked by volatility



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

There are a number of observations that can be made from this analysis:

- The highest average net returns (and best risk return trade-off) can be found among mid volatility MySuper products;
- There are not marked differences between either administrative or total fees across the cohorts;
- Although the highest volatility / lowest return cohort have higher than average administrative fees, the median total fee of the cohort is lower than average;

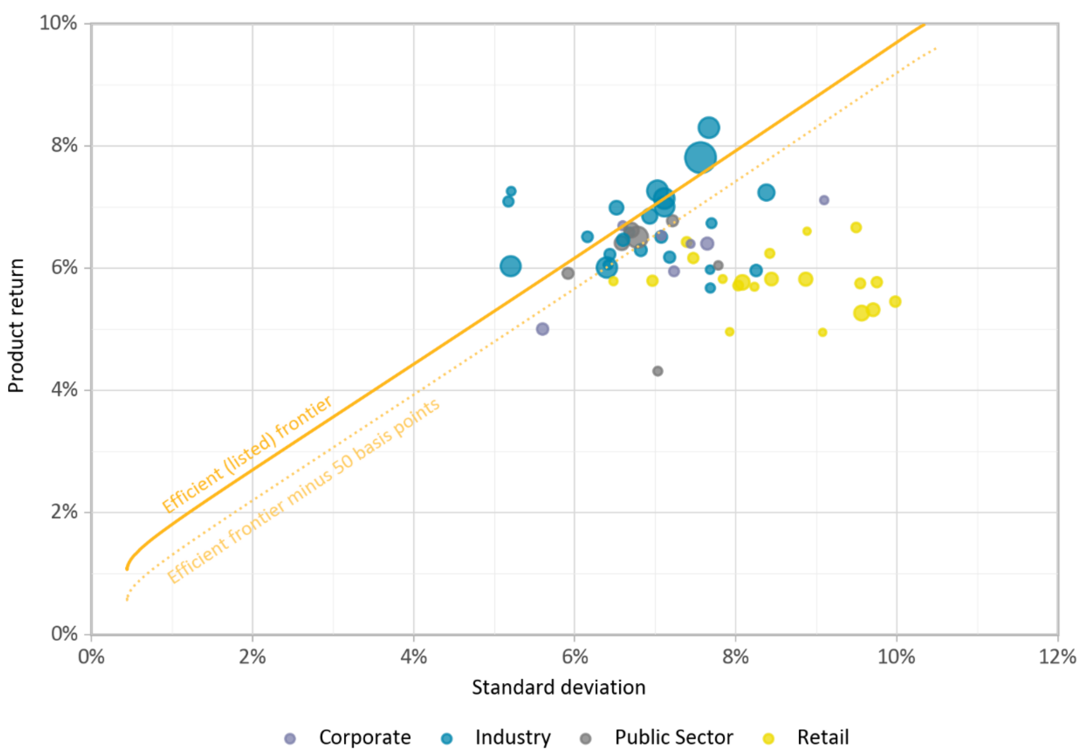
- For this cohort it is possible the current year RAFE and total fees don't accord with long term fees of the products or the RAFE and total fees are an underestimate;
- Almost all (13 of 14) products among the high volatility low return cohort are retail MySuper products.

This analysis suggests further examination of the way fees are measured in the performance test is needed as well as a more detailed consideration of risk return efficiency, particularly if a simplified benchmark is pursued.

Measuring risk return efficiency

An alternative way of assessing the risk return efficacy of MySuper products is to benchmark them on their returns and observed volatility compared to an efficient investment frontier – see figure 9 below. This type of analysis effectively standardises returns based on risk quotas, and based on thousands of portfolio simulations constructed from low risk to high risk.

Figure 9: ***MySuper product returns and volatility vs efficient frontier***
Eight years to June 2022



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA performance test benchmark indices (see page 22 of Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021 for details).

While the volatility (standard deviation) of returns is only one measure of risk, it is one which members are most likely to notice. A key finding of this analysis is that most retail MySuper products are risk return inefficient – exposing members to up to twice the risk than their returns justify or around 2% per annum lower returns than other MySuper products with similar or lower risk.

These systemic differences in the observed risk return efficiency of MySuper products warrants closer examination by the review.

Performance test treatment of fees

In its 2018 report into superannuation efficiency and competitiveness, the Productivity Commission found a relatively clear relationship between observed fees and net return outcomes consistent with published academic literature. Using option level data, the Commission found a strong negative relationship between net returns and total fees.[6] In its cameo analysis, the Commission found that a 0.5% difference in fees can cost a full-time worker about 12% of their balance (or $100,000) by the time they reach retirement.[7]

It is therefore appropriate that the performance test seeks to capture fees, although it does so in a most unconventional way. As noted, the performance test backs out the effect of administrative fees from historical net returns by using a net investment return metric for the benchmark with an ex-ante administrative fee adjustment reflecting the fee a trustee sets in the year a performance test is conducted.

This approach was not consulted on when the exposure draft regulations were originally released[8] – on the contrary, the draft regulations envisaged the use of the full lookback period for administrative fees – in effect treating them in the same way as investment fees and costs.

The changes which were made public only when the final regulations were made were largely the result of lobbying by the retail sector which has historically attempted to obscure or remove entirely the effect of administrative fees and commissions on net returns.[9]

The consistent attempts to obscure the effect of such fees on net returns had previously led the Cooper Review to conclude:

> It is illogical and misleading for investment returns to be reported to members on anything other than an after tax-basis and after all costs have been deducted.[10]

As it stands the treatment of fees and how they are measured in the test results in an unexpected relationship between net returns and total fees, and a seemingly incomprehensible relationship

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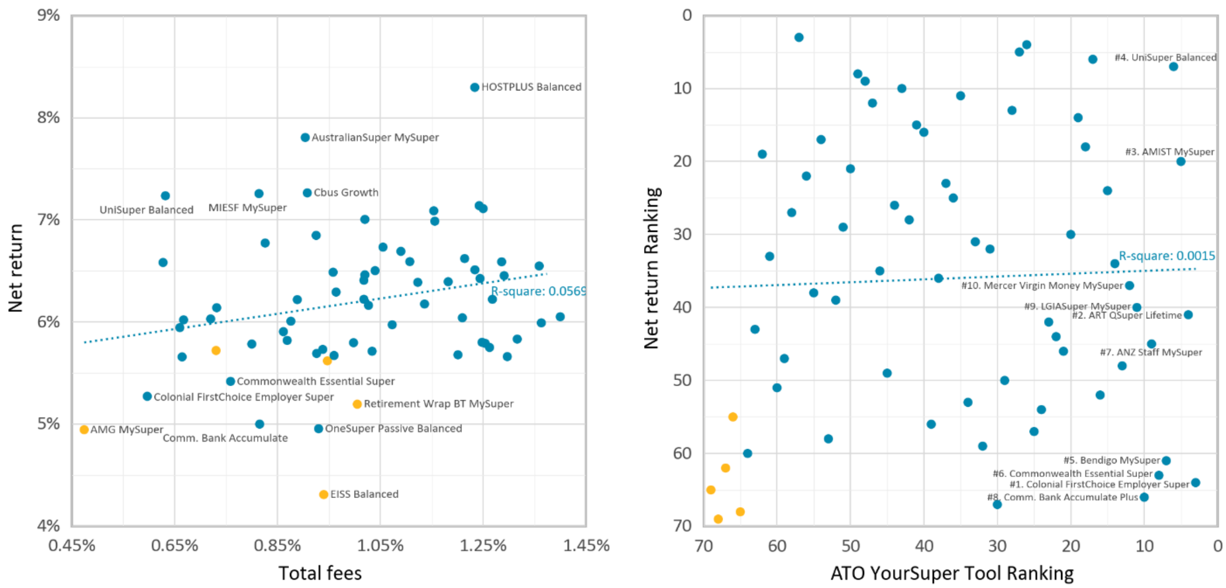
[6] Productivity Commission, Superannuation: Assessing Efficiency and Competitiveness, Report 91, December 2018, box 3.4 p. 186 and figure 3.2 p. 187.
[7] Ibid – Cameo 3, p. 14.
[8] Treasury consultation – Your Future Your Super Regulations and Associated measures, 28 April 2021-25 May 2021, https://treasury.gov.au/consultation/c2021-162375.
[9] For example, the Financial Service Council in 2010 proposed to make a new reporting standard for its members (Standard 6B) which would have required its super fund members to report returns net of tax and investment costs but gross of administrative and adviser fees paid by members.
[10] Super System Review Final Report – Part 2 page 111

between net returns and the default ranking in the ATO performance tool (using fees) – see figure 10 below.

Figure 10: ***Net returns and total fees 8 years to June 2022; Net return and ATO YourSuper tool rank***

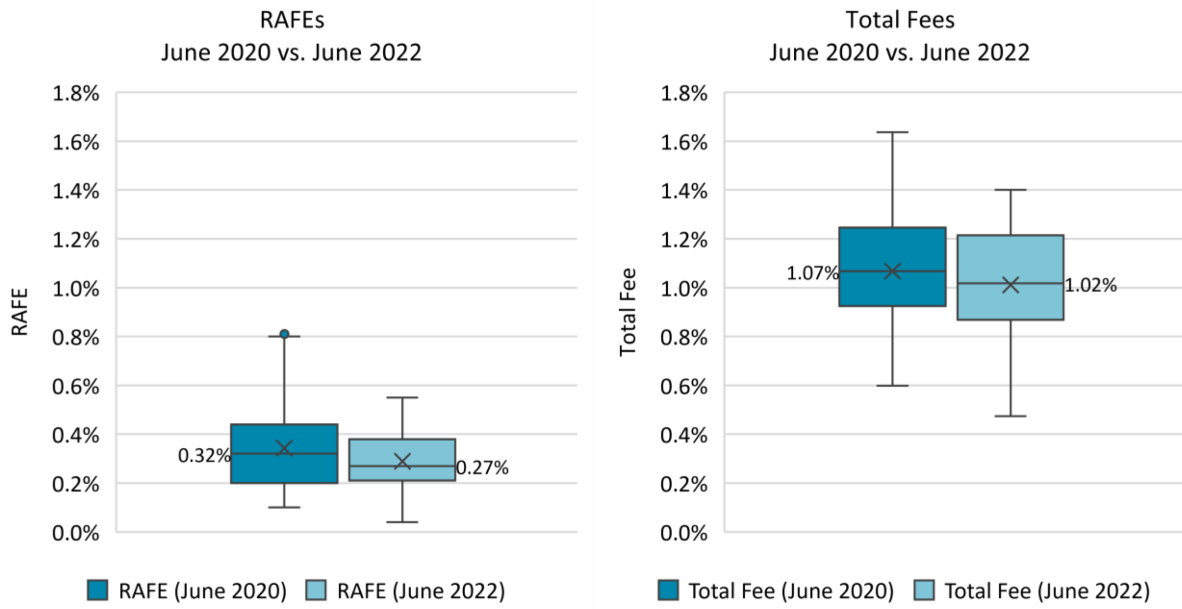


Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), ATO YourSuper Comparison Tool (June 2022).

Fee changes since the inception of the test

Since the inception of the test there is no doubt RAFEs have declined with a diminished spread between the lowest and highest RAFEs. Median RAFEs for a representative member have declined by a modest 0.05%. Total fees have reduced by a similar quantum – see figure 11 below:

Figure 11: Change in the distribution of product RAFE's and total fees, 2020-2022



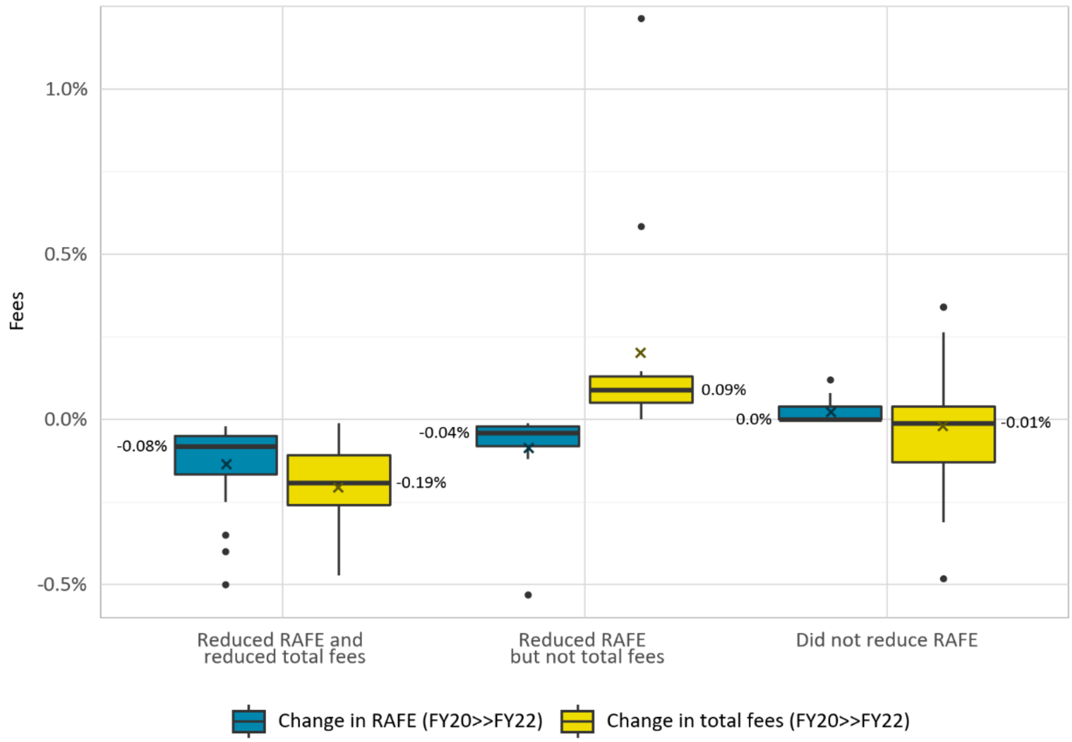
Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).
Note: Analysis for total fees exclude products with no Total fee data for June 2020.

On face value this is positive but further examination is warranted particularly since administrative fees and investment fees can move independently of one another. In terms of fee adjustments for the 67 products subject to the 2022 performance assessment:

- 36 reduced RAFE (around half of total products) and 31 did not reduce RAFE;
- But of the 36 that reduced RAFE, 23 had a reduction in total fees and 13 did not – either no change or increase;
- 40 products had a reduction in total fees (the median reduction was 0.15%).

The administrative and total fee changes for these three cohorts is shown below in Figure 12.

Figure 12: ***Change in fees 2020-2022, by fee change cohort***



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

When these representative member fee changes are applied to each product's funds under management, there was a total of $410 million in fee savings for products that reduced their fees but after accounting for products that reported increases in fees the net change was an increase of $558 million.

How fees are measured – the effect of RG 97

This does not seem like an intuitive or expected outcome from the performance test, but it likely reflects ongoing issues with fee disclosure under RG 97 which has seen some notional fee increases of many high performing products (including for instance defining taxes such as stamp duty which are levied on the acquisition of real assets purchased directly by funds as fees). As figures 2 and 3 above show, it is not apparent that the way fees have been redefined by RG 97 is having any impact on net return outcomes for members.

Changes in product level fee disclosures that bear little relationship to after-fee and after-tax return outcomes experienced by members suggest ongoing problems with fee disclosures related to RG 97. In many instances trustees have been required to disclose arbitrary changes associated with how fees and costs have been defined by RG 97 rather than any change in underlying fees or costs borne by members.

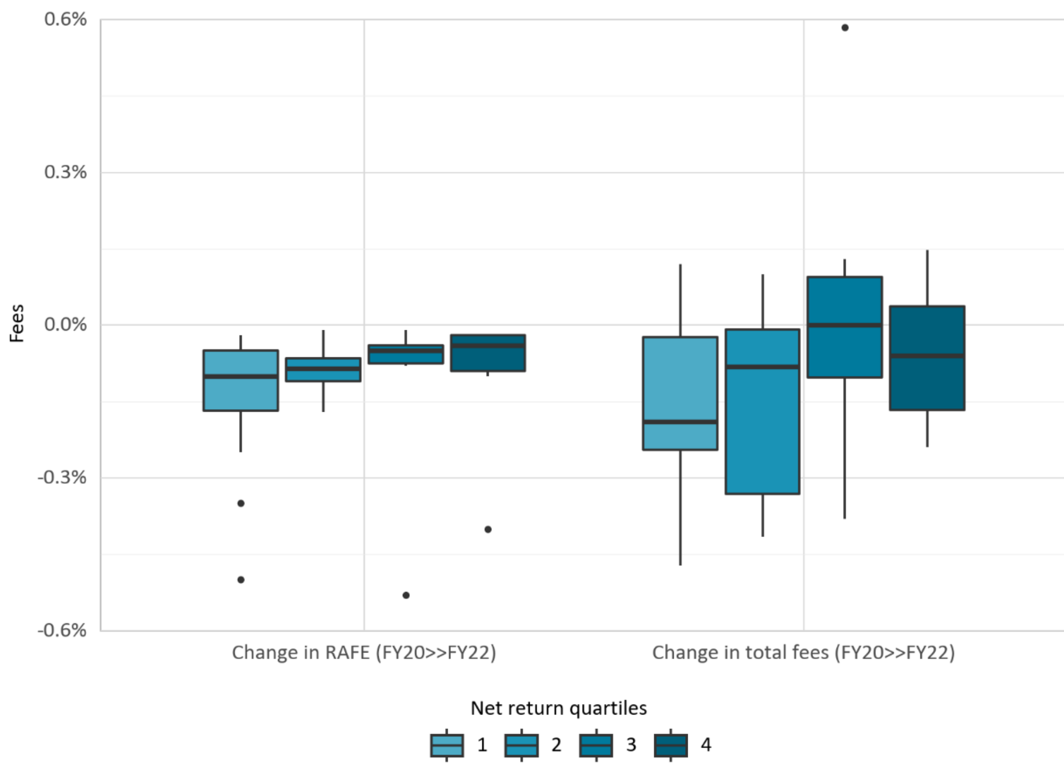
Additionally, concerns remain about the neutrality of the disclosures linked to the way in which funds offer investment options to members (whether directly by the trustee or via platforms) and the way in which funds acquire and hold assets.

Recommendation: The basis for RG 97 and related data collections utilised for performance testing should be reviewed to ensure fees and costs borne by members are treated consistently regardless of how products are offered to members (whether directly by a fund or via a platform) and how funds access underlying investments (directly or indirectly).

Fee changes by performance rank

It's useful to consider the distribution of fee changes by net return cohort to assess where fee changes are occurring. Figure 13 below shows the distribution of fee changes from 2020-2022 by 8-year net return quartile.

Figure 13: Fee change distribution by net return quartile



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022).

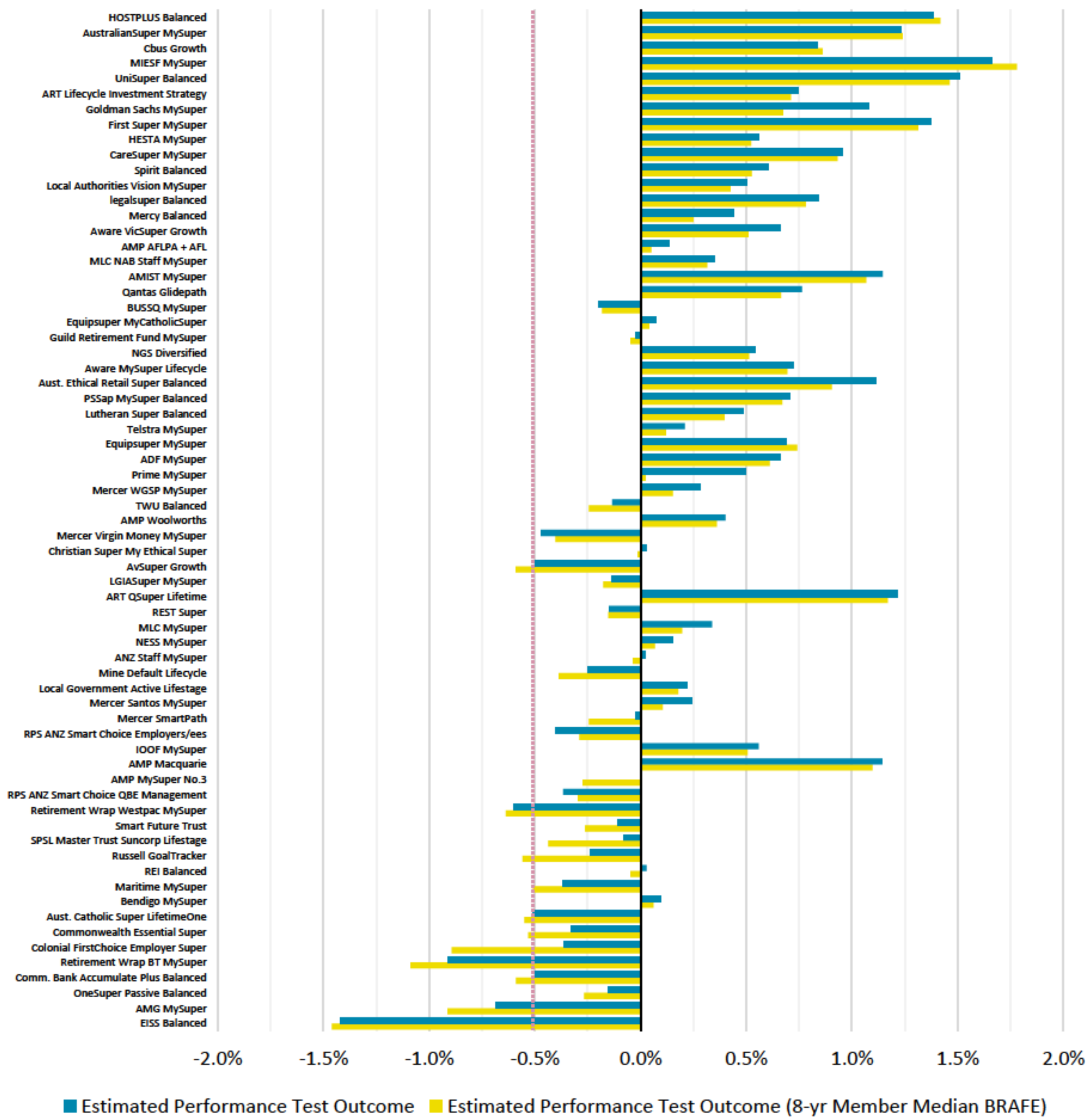
At the median level, fee reductions are evident among funds in the bottom two quartiles by performance rank although the median change in total fees is between 0.1% to 0.2%. While this is clearly welcome it is not sufficient to materially improve member outcomes for members in these poorer performing products and as previously shown it is not apparent it is helping to close the net return gap to better performing products.

Overall impact of the 12-month RAFE on performance test outcomes.

The use of a 12 month RAFE in the performance assessment has had a significant impact on the performance test results.

Figure 14 below shows estimated performance test outcomes had the final regulations reflected those originally consulted on in May last year, with the exception of using a median member rather than median product fee.

Figure 14: Estimated performance test outcome vs 8 year BRAFE/ RAFE, June 2022



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual Superannuation Performance Test - 2022, APRA Quarterly Superannuation Performance Statistics (June 2022), APRA Annual MySuper Statistics (June 2021).

Overall, the decision to use a 12-month administrative fee rather than an 8-year administrative fee fully reflected in the net returns of each product coupled with the use of an 8-year member median benchmark administrative fee has a significant impact on the overall outcomes. Specifically, the final regulations reflected in the current test:

- More than halved the number of products failing from 11 to 5 in the 2022 test.
- Improved the test outcomes by an average of 0.06% overall but 0.10% for corporate MySuper products and 0.20% for retail MySuper products.

An important outcome from the emphasis placed on the 12-month administrative fee is that it has permitted trustees who have been running otherwise failing or near failing products to reduce administrative fees modestly to pass the test but have only marginal overall improvement to net return outcomes to members relative to superior products.

Objectively assessed, rather than improve member outcomes it has, in all likelihood, had the opposite effect – it has allowed poor performers to evade the consequences of test failure including informing their members they are in a poor performing product and to find better alternatives.

Impact of using a median product RAFE rather than member account RAFE

The more appropriate benchmark is the median member *account* RAFE across all APRA super regulated MySuper products, because superannuation member accounts and funds are not evenly distributed across products.

The largest MySuper products have more than 200 times more members than the smallest products. The number of products is also unstable and subject to change.

Using the median member fee would better reflect the representative typical fees paid by members reflecting the benefits of scale achieved by funds which have higher membership bases.

ISA analysis of the median product fee in 2021-22 reveals it is set at a level that is higher than what two-thirds of MySuper members pay, equal for 8 percent of members, and is lower for just 27 percent of members.[11]

The selection of the median product fee is not representative of what members pay and makes it easier for high admin fee products to meet the performance test.

Additionally, there is no basis for a separate administrative fee benchmark for different product types.

Using a separate administrative fee benchmark for trustee-directed and other choice products may inappropriately entrench high fees with significant profit margins.

The performance tests should be based on administration fees for the full duration of the test so that they both: accurately reflect the outcomes received by members; and incentivise funds to not only reduce administration fees but to keep them low. Further, the benchmark administration fees (BRAFE) should be based on a member-weighted administration fee rather than a product-weighted fee.

[11] Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual MySuper Statistics (June 2021).

Recommendation: The performance test should be based on the product's RAFE for the duration of the test, and the BRAFE should be member-weighted rather than product-weighted.

Alternative benchmarking approaches – a Simple Reference Portfolio

Allowing funds discretion to select their own benchmarks and account for fees from the previous year only has created a gulf between passing the performance test and achieving better member outcomes.

Evidence showing funds have gamed the test by selecting easier benchmarks and selectively reducing fees supports the need for a different approach.

A better approach is likely to be found in using a simple reference portfolio, or naïve benchmark, to assess the performance of products and answer the question – is value being created for members?

That is – are sophisticated investment managers adding value for members, over and above what members could achieve if they invested in a 'simple', low-cost portfolio of potential investments?

New Zealand's Sovereign Wealth Fund uses a Simple Reference Portfolio

New Zealand's Sovereign Wealth Fund, the New Zealand Super Fund, has used a Reference Portfolio as its benchmark since 2010.

The Reference Portfolio serves as a representative alternative portfolio to the actual portfolio that the Fund invests in. It is a notional low-cost, passively managed, and well-diversified portfolio of listed asset classes that are consistent with the Fund achieving its return objectives without undue risk.

The Fund exercises judgement in constructing its actual portfolio, based on its assessment of current asset pricing from long-term fair value. These decisions can then be compared with the alternative of simply holding the Reference Portfolio. In this way, the Reference Portfolio is a device used to hold management to account for its actual portfolio decisions.

The Reference Portfolio differs from the SAA approach in that:

- It is a benchmark, not a guideline for the actual portfolio's composition,
- It contains traditional asset classes only, and
- It is not affected by short-term market conditions.

Compared to the use of an SAA, it encourages a greater separation between governance and management. It allows the Fund to focus on long-term strategic decisions and how they can add value over and above what can be achieved by simply implementing the Reference Portfolio.

The Reference Portfolio is subject to five-yearly reviews to ensure it remains appropriate, with the last occurring in 2020.[12] Key considerations for the review included composition of the portfolio, expected return and risk, interest rate and inflation risk hedging, currency hedge ratios and benchmark indices. It

[12] Hyde, Carly Falconer, Christopher Worthington and Matthieu Raoux, "How We Invest" White Paper, The 2020 Reference Portfolio Review, January 2021, at https://www.nzsuperfund.nz/publications/papers-reports-reviews/how-we-invest-white-paper/.

was decided to retain the asset allocation of 80 per cent to growth assets and 20 per cent to income assets. The main change from the 2015 review was the decision to combine developed and emerging market equities into a single building block, global equities.

A naïve reference portfolio, or variations on it could be readily implemented to assess MySuper products which are designed for relatively disengaged members. The use of a simplified test should be complemented by a follow up assessment of products which fail, allowing any claims related to the underlying risk of the products to be considered carefully.

Recommendation: Consideration should be given to replacing the existing product specific SAA benchmark with a simple naïve benchmark for all MySuper products comprising a simple low-cost diversified portfolio to assess whether trustees are adding value to members savings.

Recommendation: Coupled with a simplified transparent test any products that fail be subject to 'a show cause' and more granular assessment of the risk return trade-off for members.

Measuring value added

Using the Reference Portfolio as a benchmark means the Fund can quantify the value it creates over and above what the Reference Portfolio would achieve (table 1).

For example, over the past 10 years, the New Zealand Super Fund has exceeded the Reference Portfolio return by 1.93% per annum, or NZ$9.26 billion (after costs, before tax).[13] In recent years, the composition of the Fund has become increasingly different to the Reference Portfolio, and the Fund has moved visibly ahead of the Reference Portfolio's returns.

Table 1: Measuring value added by the New Zealand Super Fund
Fund performance (after costs, before tax), 30 June 2021

	Ten years *per cent pa*	Five years *per cent pa*	One year *per cent*
Actual fund returns	13.01	13.87	29.63
Reference portfolio return	11.08	12.64	27.90
Value added (actual return *less* reference portfolio return)	1.93	1.23	1.73
Estimated $ earned relative to reference portfolio	***$9.26 b***	***$2.92 b***	***$0.76 b***

Source: New Zealand Super Fund, Returns compared with the reference portfolio: *https://www.nzsuperfund.nz/performance/investment/returns-compared-to-the-reference-portfolio/*

[13] See https://www.nzsuperfund.nz/performance/investment/returns-compared-to-the-reference-portfolio/.

The ability to measure the value added by adopting a particular strategy, not just implementing a given strategy, is a critical feature that should be measured by a performance test. Yet it is a key feature missing from the current YFYS test.

Such value-add calculations can be made at the fund level but also at the representative member level, showing a member how much they have gained (or lost) relative to the benchmark, as well as to better assess the differences across products.

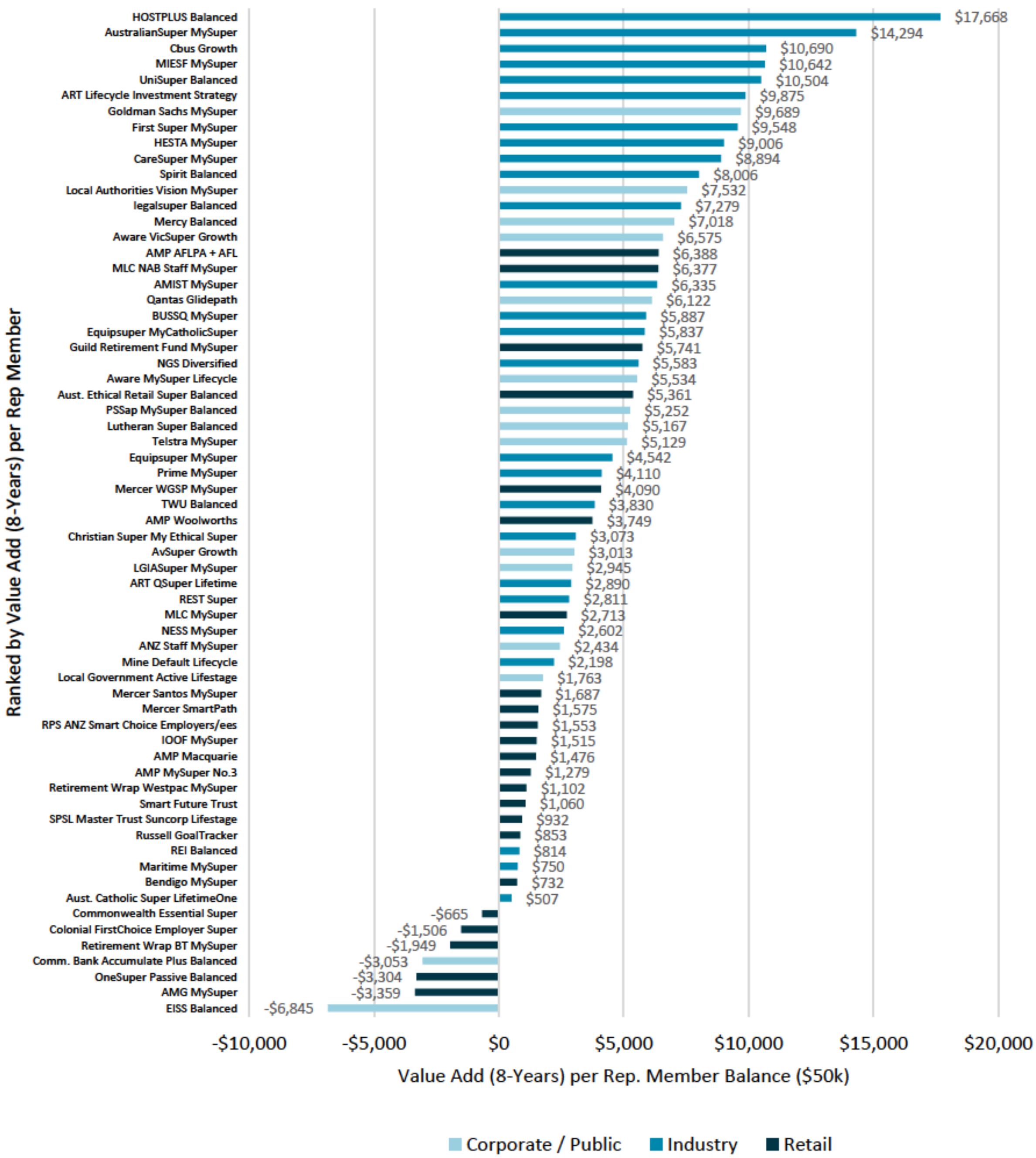
To illustrate a member-focused presentation, ISA has constructed a naïve 70/30 reference portfolio to assess MySuper products against. Using similar fee assumptions to the APRA performance test, seven products underperformed the 70/30 portfolio. Figure 15 below shows the outcomes of an 8-year net return comparison to a naïve portfolio consisting of 70 percent listed equities (equally split between domestic and international) and 30 percent fixed interest (domestic and international) and cash.

As figure 15 below demonstrates, outcomes at a member-level vary significantly from a loss of almost $7,000 over 8 years from the worst product to a gain of $17,600 for the top performing product – a difference of almost $25,000. The publication of member-level value-add could significantly improve member engagement around performance and lead to the selection of better products and enhanced member outcomes.

Recommendation: APRA should publish dollar value estimates of value add (or loss) to members with a representative balance based on the compounded annual outcome of the performance test.

Figure 15: MySuper member value-add compared to 70/30 naïve portfolio

Eight years to June 2022



s 22

From: Your Future Your Super
Sent: Wednesday, 3 May 2023 11:01 AM
To: s 47F (Australian Super - Unclassified)
Cc: s 22 Spear, Luke; s 47F
Subject: RE: AustralianSuper submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

OFFICIAL

Thank you for your email.

Treasury has received your submission.

Please note that all information (including name and address details) contained in the submission will be made available to the public on the Treasury website unless you have indicated that you would like all or part of your submission to remain in confidence. Please confirm via reply email if there are any aspects of this submission which you would like to remain in confidence.

Kind Regards,

Retirement, Advice and Investment Division

treasury.gov.au
Langton Crescent, Parkes ACT 2600
Twitter | LinkedIn | Facebook

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

LGBTIQ+ Ally

OFFICIAL

From: s 47F @australiansuper.com>
Sent: Tuesday, 2 May 2023 5:24 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Cc: s 22 @treasury.gov.au>; Spear, Luke <Luke.Spear@treasury.gov.au>; s 47F @australiansuper.com>
Subject: AustralianSuper submission - Superannuation Performance Test Regulations 2023

Please see attached.
Regards

s 47F
Strategy, Reputation & Corporate Affairs
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AustralianSuper

AustralianSuper

2/05/2023

s 22
Director, Members Outcomes and Governance Branch
Retirement Advice and Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

Via email: **yfys@treasury.gov.au**

Dear s 22

Superannuation Performance Test Regulations 2023

AustralianSuper welcomes the opportunity to provide a written submission regarding the draft Superannuation Performance Test Regulations 2023. We acknowledge and thank the Government for their ongoing commitment to the improvement of fund performance for Australian superannuation members.

AustralianSuper is Australia's leading superannuation fund and is run only to benefit members. Three million Australians are members of AustralianSuper and we invest over $280bn of their retirement savings on their behalf. We act in members' best financial interests by helping members achieve their best financial position in retirement.

Ongoing weaknesses of the performance test

AustralianSuper has long been a supporter of performance testing. We have consistently and unambiguously supported the stated policy to measure fund performance in a consistent and universal manner to assist members to compare fund performance and, by extension, highlight the best and worst performing funds over the long term. Given the compulsory nature of Australia's retirement system and the importance of funds acting in the best financial interests of members, we support measures that ensure only strong long-term performing funds receive Australians' superannuation contributions.

We reiterate our previous position on the performance test, namely that the test:

- only measures how well a fund has implemented its own chosen strategy, not whether the strategy itself is effective in generating strong returns for members over the long term
- is therefore largely an attribution exercise – where each fund compares itself against its own strategic asset allocation (SAA)
- does not adequately capture the value-add that a fund may generate from asset allocation decisions by Trustees
- rewards a poor investment strategy that is implemented well, and
- applies an inconsistent timeline between investment performance (8 years expanding to 10 years) and administration fees (1 year).

Consistent with these concerns, we consider that reforms should be made to the YourSuper Comparison Tool to ensure that the default is that products are sorted from highest net returns to lowest net returns.

We remain of the view that the performance test should be adjusted to reflect relative performance against a universal industry benchmark (tailored to the respective product type). This has the dual benefit of ensuring a more objective test is applied to all industry participants, as well as providing consistency and clarity to members seeking to use the information to make decisions about their retirement savings.

We do not believe that additional benchmarks or more granular benchmarks will improve the effectiveness of the current performance test. We question the value of adding complexity from a member and comparison perspective.

Additionally, all APRA regulated superannuation products should be subject to performance benchmarking, and annual performance assessment, not just MySuper and Trustee Directed Products. This includes Choice products and retirement products. The performance of retirement products is particularly important given a member in retirement does not have an extended period of time to build savings like a member earlier in their working life.

The proposed changes

Under the proposed regulations, the performance test continues to measure how well a fund has implemented its own strategy, not whether the strategy is effective in generating strong returns for members over the long term. By adding more asset classes / sub-asset classes, the performance test will likely become more permissive in measuring how effective the strategy has been in generating returns for members.

The addition of more asset classes and benchmarks is proposed to "neutralise tracking error". Whilst some in the industry have advocated for more asset classes and benchmarks to "neutralise tracking error", this only serves to further eliminate the incorporation of asset allocation and portfolio construction decisions in the test. The test becomes an even more granular attribution exercise – where each fund compares itself against an increasingly granular and self-defined SAA.

We continue to advocate that actual net performance over a long-term period (such as 10 years) against a universal industry benchmark (tailored to the respective product type) would be a far better approach, testing all aspects of an investment strategy – i.e. asset allocation, portfolio construction and security selection. By contrast, under the proposed changes, the test becomes increasingly anchored in just security selection, which is generally the least important of the three aspects for generating net member returns.

We understand the rationale for introducing the additional benchmarks at a more granular level. However, the proposed changes do not address the ongoing risk of funds 'hugging the benchmark' and the test outcomes are still not well-aligned with outcomes for members that incorporate all dimensions of performance a fund can control.

Detailed analysis of the benchmarks can be found in the **Attachment**.

Timeframes and administration fees

We support the staged extension of the testing period from eight to ten years as previously recommended by AustralianSuper. Ten years is a timeframe already required by APRA for product dashboards and the consequential disclosures designed to provide members with decision-making information about superannuation products.

We are still not aware of any compelling rationale for the performance test to apply a one-year timeframe for administration fees. Superannuation is a long-term investment. The investment performance period is eight years (and being extended). Net benefit is what is most important to outcomes in members' best financial interests. We have seen funds adjust their administration fees to change their administration and performance history, in a way that may be short term and not reflective of long-term administration savings. The one-year timeframe for administrative fees represents an inconsistency at the heart of the performance test. It makes the performance test less reflective of strong long-term performance in generating net benefit for members.

Coverage

We welcome the extension of the test to Trustee Directed Products and encourage the Government to extend the test to <u>all</u> APRA regulated superannuation products, including Choice products and retirement products.

We note that in 2021 APRA calculated the value of funds under management in Choice products that will not be Trustee Directed Products as 33% of FUM of all APRA-regulated superannuation products.[1] Consequently, the measures still do not provide Australians with a complete picture of fund and product performance, to enable them to make informed choices regarding the fund which best suits their circumstances.

Retrospective vs prospective

We understand there is a range of views and complexity regarding whether the proposed new benchmarks are applied retrospectively or prospectively. We do not support the new benchmarks being applied retrospectively.

Under the proposed changes to introduce additional benchmarks, funds can potentially choose a 'new' benchmark that improves the outcome for a particular product (and essentially rewrite history).

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[1]APRA – 13 April 2021 - Senate Economics Legislation Committee - ANSWERS TO QUESTIONS ON NOTICE - Treasury Laws Amendment (Your Future, Your Super) Bill 2021.
https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABYFYS/Additional_Documents

Access to benchmark data

Gaining access to each new benchmark potentially imposes a cost on each fund and by default each member. We agree with the Australian Institute of Superannuation Trustees' (AIST) recommendation that Treasury should initiate a process for commercially provided indices to be made available to super funds on a collective and cost-effective basis.

We would be pleased to provide additional information or to discuss this submission in further detail. If that would be of assistance, please do not hesitate to contact s 47F , Acting Head of Government Relations and Public Policy s 47F @australiansuper.com).

C.N.Cramond

Regards

Mark Comer & Chris Cramond

Joint Acting Chief Strategy & Corporate Affairs Officer

Attachment: Covered asset classes and benchmarks

Attachment – Covered asset classes and benchmarks

Our view remains that fewer benchmarks is better than more: ideally relative performance would be assessed against a universal industry benchmark (tailored to the respective product type). That being said, we understand this may not be feasible in the confines of the Review and therefore make the following comments in regards to some of the proposed benchmark changes or additions (items 3 and 48, Schedule 1 to the draft regulations; proposed sub-regulation 9AB.17(7) Table of covered asset classes).

a. International Equity (developed markets and emerging markets)

We see this change as unnecessary and would question the premise of the problem that it is trying to solve. The existing benchmark for international equities (MSCI All Country World Ex-Australia Equities Index ("ACWI") with Special Tax) includes a look-through exposure to emerging markets, which has ranged from circa 11% - 14% in recent years.

The ability to split out developed markets and emerging markets as part of international equity SAAs is seen as necessary from a number of industry participants. A common refrain is that funds have a tactical, strategic or structural overweight to emerging markets compared to the MSCI ACWI index weight, which creates tracking error versus the test. We would contend that such an overweight is likely initiated in order to achieve outperformance over developed markets. Conversely, funds may have an underweight to emerging markets. Either way, RSEs should be held to account for this decision as a value adding or value detracting decision and the tracking error was known and understood at the time of the decision(s) as one of the most important decisions that an RSE makes in setting an international equities portfolio. Therefore, we see this delineation as unnecessary and the apparent need to "neutralise tracking error" in international equities will only serve to mask poor decisions. When combined with the ability to make changes retrospectively, we are concerned that funds who have made poor decisions in this area will be incentivised to re-categorise poor portfolio construction decisions as SAA decisions.

b. International Unlisted Property

In the time available for consultation and given the cost involved to access new indices, we have not been able to access the time series or the characteristics of the proposed benchmark (MSCI Global (excl. Pan Europe and Pan Asia Funds) Quarterly Property Fund Index (Unfrozen) hedged). However, we have been able to access the Index Methodology and note the following criteria: *"Carry no more than 60% leverage, where leverage is defined as the ratio of total debt to the fund's total Gross Asset Value."* This level of leverage would likely be a great deal larger than most funds' typical core unlisted property exposures and therefore create a risk mismatch (with substantially higher leverage than the Australian unlisted property fund index), or encourage funds to pursue higher risk strategies in unlisted property, which may not be in members' best financial interests. Funds also cannot re-orient their international unlisted property strategy rapidly to account for a new benchmark. We would recommend that this benchmark not be introduced at this time, to allow for further consultation with the industry. Whilst the Australian unlisted property index creates tracking error versus international unlisted property, this tracking error is known and understood by industry participants and the style of investment is likely to be more similar, even if the region is not.

c. Fixed Interest

i. Australian Fixed Interest (Bloomberg Ausbond Master 0+ Index)

The Bloomberg Ausbond Master Index includes Inflation Linked Bonds (ILBs). We understand some funds invest a material SAA in ILBs and therefore it may have seemed prudent to introduce an index with an allocation to ILBs. However, we believe it would be more pragmatic to retain the previous benchmark (Bloomberg Ausbond Composite Index). The Australian ILBs market has not developed to the point where the liquidity allows us as managers to make active decisions around this sector allocation. Likewise, building even an index weight would likely take many months or years, due to the low liquidity in this market. The extended duration of the ILB index reduces its attractiveness for any defensively styled investments. Any portfolio or option that retains a CPI linked benchmark is not properly hedged by these ILBs given the moves in Break Even Inflation (BEIs) / real yields will be the dominant return factor rather than capital accrual from principal indexation.

ii. Australian Credit / International Credit

We see an inconsistency in the way that credit indices are specified between Australian and international credit. For international credit, the Bloomberg Global High Yield Index hedged is used (sub investment grade), whereas for the Australian index, a corporate investment grade index is used. The coverage and risk profiles of these indices are very different. The High Yield Index also has a longer duration than is typically used by funds and where a floating rate sub-investment grade index (such as the Morningstar Leveraged Loans Index) would be more appropriate. However, we would not support the proliferation of credit benchmarks and again stress that less benchmarks are likely better than more.

If limited to one credit index we strongly prefer an international investment grade credit benchmark to better align the respective groupings between Australian and international fixed income. Therefore, for international credit, an index such as the Bloomberg Global Credit Index or the Bloomberg Global Corporate Index would be preferable.

d. Growth Alternatives / Defensive Alternatives

Given the proposed introduction of two additional alternatives sectors, “Defensive Alternatives” and “Growth Alternatives”, with different allocations to the underlying international equities and fixed interest benchmarks, we see the potential for this to be too tolerant with the majority of funds likely to choose defensive alternatives. There is no industry-agreed definition of a “growth alternative” versus a “defensive alternative” and we see the potential for inconsistency and/or misinterpretation, given the self-defined nature of the investments and the permissive nature of the classifications. This is particularly given the disparity in benchmarks between the two (i.e. 75% equities / 25% fixed interest for growth alternatives and 25% equities / 75% fixed interest for defensive alternatives). We therefore see a disincentive for funds to disclose ubiquitous alternative assets as “growth alternatives” even if the characteristics of the investment would suggest as such.

When combined with retrospectivity and given the result for the majority of the nine years to 30 June 2023 will be known, we see the potential for the benchmarks to become highly permissive. The need for surveillance from APRA will be significant and potentially burdensome, particularly in a largely self-defined asset class. Compared to traditional asset classes (for instance, it would be difficult to re-categorise a pool of equity investments as fixed interest), the ability to oversee RSE’s self-classification of alternatives as either growth or defensive alternatives would seem difficult.

s 22

From: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Sent: Wednesday, 3 May 2023 4:34 PM
To: s 47F ; Spear, Luke
Cc: s 47F Industry Super Funds - Unclassified); s 47F
Subject: RE: ISA submission - Performance test regulations [SEC=OFFICIAL]

OFFICIAL

Thank you for your email.

Treasury has received your submission.

Please note that all information (including name and address details) contained in the submission will be made available to the public on the Treasury website unless you have indicated that you would like all or part of your submission to remain in confidence. Please confirm via reply email if there are any aspects of this submission which you would like to remain in confidence.

Kind Regards,

Retirement, Advice and Investment Division

treasury.gov.au
Langton Crescent, Parkes ACT 2600
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The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

LGBTIQ+ Ally

OFFICIAL

From: s 47F @industrysuper.com>
Sent: Wednesday, 3 May 2023 11:03 AM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>; Spear, Luke <Luke.Spear@treasury.gov.au>
Cc: s 47F (Industry Super Funds - Unclassified) s 47F @industrysuper.com>; s 47F @industrysuper.com>
Subject: ISA submission - Performance test regulations

Good morning

Please find attached ISA's submission in response to the Superannuation Performance Test Regulations 2023 consultation.

We apologise for the slight delay in sending this through. If you have any questions, please feel free to contact me or s 47F

Kind regards

s 47F

Policy Adviser
Industry Super Australia

M: s 47F
Level 39, Casselden, 2 Lonsdale Street, Melbourne, VIC 3000
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Industry Super Australia

Your Future, Your Super Review outcomes – draft Regulations

Industry Super Australia (ISA) is a collective body for funds that carry the Industry SuperFund symbol. ISA manages research, advocacy and collective projects on behalf of those funds and their five million members. Our aim is to maximise the retirement savings of all our members.

ISA broadly supports the intention of the Your Future, Your Super reforms to create a more efficient and fair superannuation system that improves the retirement outcomes of Australian workers. The introduction of an annual performance assessment has brought important accountability to funds' trustees to ensure minimum performance outcomes are being met in respect of MySuper products.

However, as discussed in our submissions to the Your Future, Your Super Review, significant changes are needed to ensure the reforms work in the best interests of members. The *Superannuation Industry (Supervision) Amendment (Your Future, Your Super – Addressing Underperformance in Superannuation) Regulations 2023* are not sufficiently resolved or comprehensive enough to address these concerns.

While we recognise that in addition to these proposed regulations, the Government has acknowledged the need to improve certain aspects of the reforms in the longer term – such as the performance test and ensuring stapling operates efficiently – ISA urges the Government to deal with these issues as soon as practicable. Continued delays will compromise the retirement outcomes of members, and making incremental tweaks to the system instead of introducing a cohesive and substantial package of reform creates unnecessary uncertainty for industry and members.

This submission focuses specifically on the *Superannuation Industry (Supervision) Amendment (Your Future, Your Super – Addressing Underperformance in Superannuation) Regulations 2023* and the Government's response to the Your Future, Your Super Review. The following recommendations therefore apply in addition to the recommendations in our previous submissions to the Review.

Summary of our submission

- ISA strongly encourages the Government to direct the ATO to change the YourSuper comparison tool so that products are sorted based on net returns by default (from highest net returns to lowest) before the 2023 performance test results are published. Where a product has a range of returns, for example lifecycle products, the product should be ranked based on asset-weighted returns across the life-stages.

- Consistent with our previous submission, ISA supports prospectively increasing the testing period from eight to ten years to encourage longer-term investment decisions.

- ISA believes the addition of extra benchmark indices and voluntary reporting further diminishes the transparency and simplicity of the performance testing regime, increasing opportunities for gaming the test. A better approach is to replace the existing product specific SAA benchmark with a simple naïve benchmark for all MySuper products comprising a simple low-cost diversified portfolio to assess whether trustees are adding value to members savings.

  If the Government chooses to proceed with the additional indices, they should only be utilised for prospective SAA reporting and performance testing from 30 June 2023.

- ISA does not support adoption of a separate performance measure or BRAFE for trustee-directed products. Administrative fees and costs should also be aligned to the lookback period of the performance test to reflect the member outcomes delivered and not omit all but the last 12 months of administrative fees and costs.

- ISA recommends that the Government do more than acknowledge that more substantial changes to the performance test may be required and commit to consulting on amendments next year to address the harm arising from the flaws in the performance test and the inefficient operation of stapling.

- ISA strongly encourages the Government to prioritise reforms to prevent inappropriate behaviour by software providers that undermines stapling reforms, by undertaking a broad consultation process to understand and respond to these issues.

- ISA supports the proposed changes to the letter funds that fail the performance test are required to send to members but encourages the Government to fix the comparison tool website to avoid connecting members with poor performing products and consider how the letter could better interact with merger discussions.

Improvements to the YourSuper comparison tool default sorting method

ISA strongly encourages the Government to amend the YourSuper comparison tool default sorting method before the 2023 results are published.

The comparison tool sorts products from lowest to highest annual fees by default, instead of by net returns. Where a product has a range of fees, for example for lifecycle products, the lowest fee is used for ranking purposes. In our view, this approach is deeply flawed and is directing consumers to poor performing products and therefore poorer retirement outcomes. While fees are an important consideration, it is net returns that matter to member outcomes.

As shown in our submission to the Review, and extracted again below, the correlation between fees and net returns is weak (see figure 1A) while there is virtually no correlation between the default rankings of the YourSuper comparison tool and long-term net return rankings (see figure 1B).

Since our submission to the Review the comparison tool rankings have changed.

The default sorting method previously resulted in Colonial First State's FirstChoice Employer MySuper product receiving top-billing, when in fact:

- this product is ranked 62nd out of 67 MySuper products in terms of long-term net returns,
- its average annual net return over the past 8-years is some 300 basis points below the market leader in Hostplus's Balanced option, and
- it failed the performance test in 2021.

Likewise, Australian Retirement Trust's QSuper Lifetime was ranked second by default but has only the 39th highest net return over the past 8-years, averaging around 230 basis points per annum below Hostplus's Balanced option.

The comparison tool also allows new and untested products to be promoted on the platform, undermining the policy intent of the tool to connect members with quality tested super products.

As at 1 May 2023, the QSuper Lifetime product was ranked first. Vanguard MySuper was ranked second, despite not having passed a performance test – the tool labels the product as 'performing' while no net return value is available for the product. New products do not face a performance test until five years of performance data are available.

The way in which the comparison tool displays and promotes new and untested products further highlights the absurd inadequacy of the current design. If the policy intent is to connect members with good performance-tested products:

- the tool should default sort by net returns,
- untested products should be more appropriately displayed, and
- the tool should be properly consumer tested.

It would be more useful for consumers if products are sorted based on net returns by default (from highest net returns to lowest). Where a product has a range of returns, for example lifecycle products, the product should be ranked based on asset-weighted returns across the life-stages.[1] Annual fees for a product can be highly variable depending on the user's age and super balance. Therefore, another benefit of using the net returns metric as the default sorting method is that it is comparatively stable.

If the policy objective of the comparison tool is to guide consumers to make positive informed decisions about their retirement savings, changes must be made to improve the comparison tool before the next performance test results are published and consequences for failure are triggered.

Figure 1A: Total fees vs net returns, June 2022

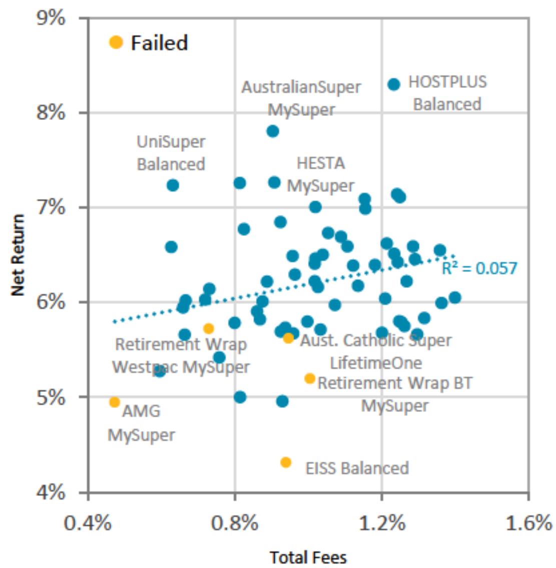
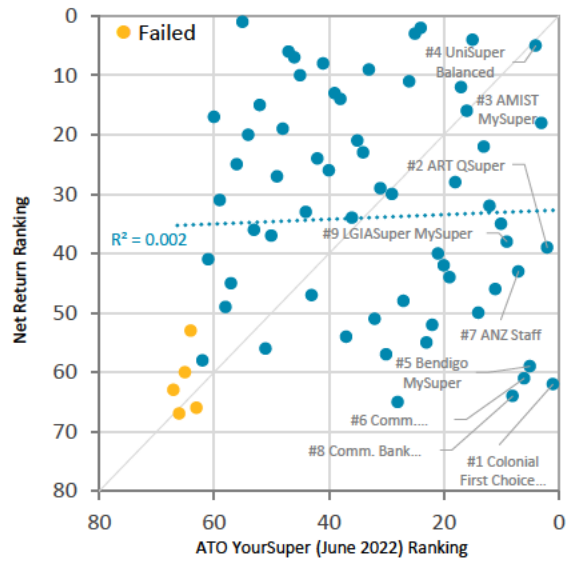


Figure 1B: Default sorting vs net return rank



Source: ISA Analysis, APRA Quarterly MySuper Statistics (June 2022), APRA Annual Superannuation Performance Test – 2022, ATO YourSuper Comparison Tool (June 2022).
Note: Total fees are expressed as percentages of representative member balances of $50,000.

Recommendation: ISA strongly encourages the Government to direct the ATO to change the YourSuper comparison tool so that products are sorted based on net returns by default (from highest net returns to lowest) before the 2023 results are published. Where a product has a range of returns, for example lifecycle products, the product should be ranked based on asset-weighted returns across the life-stages.

---

[1] The current tool produces very perverse outcomes where, for example, ranking products by net return leads to Australian Retirement Trust's QSuper Lifetime product (net return of 2.54%-7.11%) being ranked above UniSuper's Balanced product (net return of 6.93%), despite 7 of the 8 lifestages having a lower net return and the worst performing lifestage, "Sustain 2 Group", having a net return of 4.39% per annum below UniSuper's option.

Increased testing period

ISA supports prospectively increasing the testing period from eight to ten years to encourage longer-term investment decisions.

As set out in our submission to the Review, in general, products should be assessed over the longest time period possible to:

- account for risk and market cycles and allow for a better assessment of the resilience of investment portfolios along with trustees' responses,
- reflect that superannuation is a long-term investment and illiquid asset classes have inherently long horizons, and
- align with existing ten-year Government guidance and regulated disclosures for consumers on assessing returns.[2]

Recommendation: Consistent with our previous submission, ISA supports prospectively increasing the testing period from eight to ten years to encourage long term investment decisions.

Calibrating benchmarks

ISA was among those who made a strong case in submissions to the Review to move to a simplified benchmark and more robust assessment for risk.[3] Increasing the number of indices seems to move in the opposite direction.

It is unclear how the additional benchmark indices strengthen the test in their current form. While changes to the existing infrastructure benchmark will potentially better facilitate investment in renewable energy infrastructure, the addition of further indices increase the test's complexity and increase the potential for retrospective changes to strategic asset allocations (SAAs) to enable marginal products to pass. For example, for a MySuper Product with 30-35 per cent of assets allocated to International Equities, revisiting the SAA from a 90-10 split between Developed and Emerging markets to a 75-25 split improves test outcomes by around 30-35 basis points – more than enough for a fund otherwise failing the test to pass.

If the Government does proceed, important safeguards are needed to prevent gaming of the test. For example, funds should only be able to report prospectively on new SAA categories associated with new benchmark indices and not retrospectively recast their SAAs against asset allocations that cannot be verified. Actual asset allocations also need to be published so there is appropriate scrutiny on trustees that might be manipulating their SAA benchmark to pass the test.

Such resubmissions were a feature of the inaugural test with significant movement in SAA's away from higher to lower return asset classes in around one quarter of MySuper products. APRA should be attuned to material resubmissions of SAA by funds.

---

[2] ISA, *Your Future, Your Super Review – Performance test methodology supplementary submission* (15 November 2022), p. 12.
[3] See also IFM Investors, *Review of Your Future, Your Super Measures* (14 October 2022).

The addition of further benchmark indices also results in unacceptable regulatory costs that are imposed on funds. Subscription to the proposed full range of indices run into hundreds of thousands of dollars per fund which replicated across the industry result in tens of millions in costs that are ultimately borne by members. In our view, the index data should be made available to funds on a cost-effective basis and Treasury/APRA should facilitate this process.

Recommendations: ISA believes the addition of extra benchmark indices and voluntary reporting further diminishes the transparency and simplicity of the performance testing regime increasing opportunities for gaming the test. A better approach is to replace the existing product specific SAA benchmark with a simple naïve benchmark for all MySuper products comprising a simple low-cost diversified portfolio to assess whether trustees are adding value to members savings.

If the Government chooses to proceed with the additional indices they should only be utilised for prospective SAA reporting and performance testing from June 30 2023.

Performance measure and BRAFE for trustee-directed products

ISA does not support adoption of a separate performance measure incorporating different calculation of the benchmark representative administration fees and expenses (BRAFE) for trustee-directed products.

The draft regulations introduce a separate BRAFE for trustee-directed products. ISA analysis based on the most recent Choice Heatmaps (data to October 2022) shows that the median annual administration fee charged on a $50,000 super balance across Choice products was 38 per cent higher than the MySuper equivalent (40 vs 29 bps – see Table 1). In dollar terms, this amounts to $55 per annum in additional fees.

Notably, the difference in member-weighted medians between MySuper and Choice products is much smaller, at 3 basis points or $15, suggesting that the typical administration fee a member is charged across the two sectors is not as different as the product medians would suggest.

No sound basis has been provided for a separate administration fee benchmark for different product types.

Table 1: Median (product-weighted, member-weighted, asset-weighted) annual administration fees disclosed on a $50,000 account balance across MySuper and Choice products, as at 1 October 2022.

Measure	Product Weighted		Member Weighted		Asset Weighted	
	MySuper	Choice	MySuper	Choice	MySuper	Choice
Dollars	$145	$200	$130	$145	$125	$125
Percentage	0.29%	0.40%	0.26%	0.29%	0.25%	0.25%

Source: ISA Analysis, APRA Choice Heatmap, April 2023, APRA MySuper Heatmap, February 2023, APRA Quarterly Superannuation Industry Publication, June 2022. Note: Choice category includes the set of multi-sector accumulation products available through generic investment menus reported in the 2023 APRA Choice Heatmap.

Introducing a higher benchmark RAFE for trustee-directed products is therefore likely to inappropriately entrench high fees with significant profit margins. ISA analysis of APRA data shows that funds offering fewer investment options (MySuper products) have consistently performed better than funds that offer hundreds of investment options (Choice products). This analysis suggests that the proliferation of investment options is motivated by a for-profit business model in which:

- For-profit Choice funds have an interest in capturing margins at multiple points in the investment value chain including extracting fees when members change options,
- Maintaining sufficient liquidity to facilitate large volumes of investment switching means for-profit Choice funds are more likely to invest in highly-liquid asset classes for short time periods, forgoing investments in better performing but less liquid long-term assets such as infrastructure,
- Offering a multitude of investment options is used as a deliberate strategy to shift costs and risks to consumers.[4]

The latest Choice heatmaps add to the weight of evidence in support of greater measures to protect members from high fees and poor performance. They showed:

- Almost half of products with an 8-year performance history underperformed the benchmarks, with almost half of these by more than 0.5 per cent,
- Less than a third of Choice sector assets were subject to the Choice heatmap assessment, highlighting the pressing need to expose the entire sector to performance assessment, including single asset class options (some single asset class options were heatmap-assessed, with many performing badly) and retirement income products,
- Choice products closed to new members, virtually all contained within the retail sector, continue to gouge members with high fees and poor performance – two-thirds had poor or significantly poor performance relative to the benchmark and average fees were higher.

The heatmaps include some single asset class options which are not in scope of the performance test for TDPs so the upcoming extension will cover significantly less than half of Choice assets. Significant fee and performance issues continue to be exposed in the Choice sector time and time again, yet it continues gouging members while avoiding even the most basic scrutiny members should expect of a compulsory retirement income system that requires them to set aside over one in ten dollars earned.

In its 2018 report into superannuation efficiency and competitiveness, the Productivity Commission found a relatively clear relationship between observed fees and net return outcomes consistent with published academic literature. Using option level data, the Commission found a strong negative relationship between net returns and total fees.[5] In its cameo analysis, the Commission found that a 0.5% difference in fees can cost a full-time worker about 12% of their balance (or $100,000) by the time they reach retirement.[6]

[4] ISA, *Options to Lose: How "sales" became "choice" and the impact on superannuation returns* (June 2017).
[5] Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness* (December 2018), box 3.4 p. 186 and figure 3.2 p. 187.
[6] Ibid – Cameo 3, p. 14.

Consumer protections should be commensurate with the potential loss members incur when they are left in a poor performing, high fee fund, which is significant. Trustees can make commercial decisions to complicate or simplify their product offerings. The benchmark RAFE should not be used to support more complex and higher fee-paying products. In our view, the benchmark RAFE should be the same across all products (in a similar way that asset class specific investment fees/costs are standardised) so there is competitive pressure across the industry to offer products in the best interests of members.

Recommendation: ISA does not support adoption of a separate performance measure or BRAFE for trustee-directed products. Administrative fees and costs should also be aligned to the lookback period of the performance test to reflect the member outcomes delivered and not omit all but the last 12 months of administrative fees and costs.

More changes are needed

ISA notes that in addition to these proposed regulations, the Government has acknowledged the need to improve certain aspects of the reforms in the longer term – such as the performance test and ensuring stapling operates efficiently. ISA urges the Government to deal with these issues as soon as practicable. Continued delays will compromise the retirement outcomes of members, and making incremental tweaks to the system instead of introducing a cohesive and substantial package of reform creates unnecessary uncertainty for industry and members.

Recommendation: ISA recommends that the Government do more than acknowledge that more substantial changes to the performance test may be required and commit to consulting on amendments next year to address the harm arising from the flaws in the performance test and the inefficient operation of stapling.

Software providers and stapling

The stapling reforms were introduced for the important purpose of reducing the number of unintended multiple accounts. This was and remains a major source of inefficiency in the superannuation system as it reduces Australians' retirement savings through unnecessary multiple fees.

The stapling reforms, which aim to ensure that a member remains with a single fund throughout their working life unless an active decision is made to join a new fund, will only be effective if:

- the public (both employers and employee members) are aware of the fundamental importance of the stapling laws, and
- employees are, through their employer, given accurate, balanced and factual information as to the superannuation fund selection options available to them. This is critical to ensure that the fund selection made by employees, which will affect their savings over their working life and into retirement, is based on meritorious, relevant and informed considerations.

In short, the legislative system incorporating the stapling reforms should work to ensure that employees choose a strong performing fund, which best suits their individual needs and circumstances.

ISA notes the Government's commitment to address the significant issues identified in the Review in relation to stapling. The Government's response specifically identifies the inappropriate behavior by software providers which is circumventing and therefore undermining the intent and operation of the stapling laws to the detriment of members' retirement outcomes.

An example of this inappropriate conduct that has been widely reported in the media is the operation of the Flare HR platform which is owned by MYOB. The platform allows new employees using the platform to choose a fund as part of an employee's onboarding journey. One of the funds includes the underperforming and high fee Slate Super fund. Like the platform itself, the Slate Super fund is owned by MYOB.[7]

ISA understands there is a broad spectrum of conduct by software providers – some of which is inappropriate and undermines the objective of stapling. In our view, it is an insufficient and naïve response for Government to expect that the inappropriate behavior will cease voluntarily. We therefore recommend that the Government undertake a broad consultation process to better understand how these onboarding platforms operate and identify instances of inappropriate conduct. The Government should then prioritise any legislative reforms that are needed to clarify the intended policy outcome and prevent this conduct from occurring. At the same time, ASIC should also take strong and public regulatory action where appropriate.

Recommendation: ISA strongly encourages the Government to prioritise reforms to stop inappropriate behaviour by software providers that undermines stapling reforms by undertaking a broad consultation process to understand and respond to these issues.

Communicating to members of products that fail the performance test

The proposed changes are more direct, make the letter clearer and focus on action members can take to switch out of underperforming funds. However, without fixing the YourSuper comparison tool (discussed above) the letter is not connecting members with good quality funds.

The Government should also consider how the letter interacts with merger discussions that may be underway, as discussed in our submission to the Review.

Recommendation: ISA supports the proposed changes to the letter funds that fail the performance test are required to send to members but encourages the Government to fix the comparison tool website to avoid connecting members with poor performing products and consider how the letter could better interact with merger discussions.

[7] The Australian Financial Review article, "*MYOB allegedly manipulating users into joining its sub-par super fund*" (12 March 2023).

s 22

From:	s 47F @industrysuper.com>
Sent:	Friday, 23 June 2023 4:27 PM
To:	s 22
Cc:	Spear, Luke; s 47E(d) ; s 47F (Industry Super Funds - Unclassified); s 47F
Subject:	FW: For limited circulation: Performance test notification letter [SEC=OFFICIAL]
Attachments:	230614 - Notification Letter examples_ISA comments.docx

Hello s 22

Thank you for the opportunity to provide feedback on the proposed notification letters.

Overall we think they're clearer and more direct, and an improvement on the previous versions. There are a few changes we think would strengthen them. These are contained in a consolidated marked-up version of the document **attached** to this email.

In addition, we had a few other important points, questions, and clarifications in relation to the proposed letters:

- The letters refer members to the comparison tool. We've previously raised our concerns with the tool, and it's worth us reiterating the importance of making improvements including default sorting by net returns not fees and more appropriately ranking and presenting lifecycle products. These changes should occur *before* the next test to avoid members making poor choices after being referred to the comparison site.
- The letter indicates the comparison tool will continue to contain only MySuper products (consistent with the SIS Act) but we also noted the government's response to the YFYS review indicated changes to the tool would take into account the extension of the test to TDPs. Does this mean changes to the scope of the tool (and amending the SIS act) will be pursued in the next phase of reforms?
- We noted that no template letter for first failure of a non-platform TDP was contained in the document, but assumed this was because you had selected some examples to include not because trustees of non-platform TDPs that failed once would be exempt from writing to members – is this correct?
- One way to strengthen the impact of using individualised fee/returns data is by comparing it to what the top fund (or average top fund) delivered in both earnings and fee savings – we've included a suggestion in the document comments around this.
- The proposed changes you outlined around allowing trustees to send a consolidated letter makes sense.

Happy to clarify or discuss any of this with you as required.

Kind regards,
s 47F

s 47F

Industry Super Australia

M: s 47F
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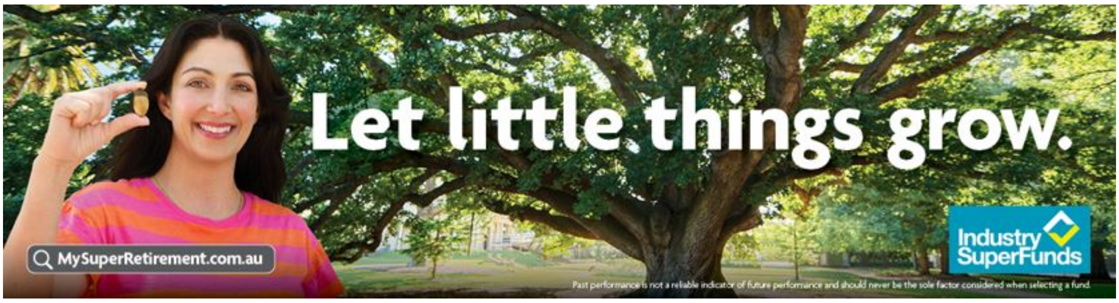

From: s 47F @industrysuper.com>
Sent: Thursday, June 22, 2023 4:19 PM
To: s 47F @industrysuper.com>; s 47F @industrysuper.com>
Subject: Fwd: For limited circulation: Performance test notification letter [SEC=OFFICIAL]

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From: s 22 @treasury.gov.au>
Sent: Thursday, June 22, 2023 4:14 pm
To: s 47F @industrysuper.com>
Cc: Spear, Luke <Luke.Spear@treasury.gov.au>; s 47E(d) @TREASURY.GOV.AU>
Subject: For limited circulation: Performance test notification letter [SEC=OFFICIAL]

OFFICIAL

Hi s

As discussed, we are interested in receiving your feedback on the proposed notification letter that will be used as part of the upcoming performance test in August 2023.

We are proposing to have separate notification letters for each of the product types: MySuper; Non-platform TDPs; and Platform TDPs. There will also be different text for when a product fails the first time (single failure) and consecutive failures.

A further change has also been made following consultation to allow trustees to send a consolidated letter to members within the product and failure type where they have more than one product fail the test. For example:

- if a beneficiary has 3 platform TDPs with a single failure (1 consolidated letter) and 2 platform TDPs with consecutive failures (1 consolidated letter), the trustee would be expected to send 2 letters to the beneficiary.
- if a beneficiary has 2 non-platform TDPs with a single failure (1 consolidated letter) and 1 MySuper with a single failure (1 consolidated letter), the trustee would be expected to send 2 letters to the beneficiary.

The attached document has four examples to showcase the key differences in letter templates:

- MySuper, single failure, one product
- Non-platform TDP, consecutive failures, one product
- Platform TDP, single failure, one product
- Platform TDP, single failure, multiple products

Grateful for any feedback you have on the attached by **COB tomorrow**. We would appreciate if you do not circulate the attached document outside the organisation as it is still subject to change prior to finalisation.

If you have any questions, please give me a call.

Regards,
s 22

s 22 — **Director**
Superannuation Efficiency and Performance Unit, Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
P +s 22

treasury.gov.au
Langton Crescent, Parkes ACT 2600
Twitter | LinkedIn | Facebook

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

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FOI 3497 Document 5a

MySuper, single failure, one product

Dear John,

Your superannuation product ABC Super MySuper has failed the annual performance test. You should think about moving your money to a different super product.

The Australian Government tests your super fund's products every year to make sure your savings are well managed for when you retire. Funds that fail this test are required by law to tell you.

You had $50,000 invested with ABC Super MySuper on 30 June 2023 and paid a total of $500 in fees in the last financial year.

Your money will stay in ABC Super MySuper unless you move it. Switching super products is easy and there are no fees.

You could save thousands of dollars more for when you retire by switching to a better product. Superannuation is a long-term investment. By earning 1% more each year for 30 years, you could retire with 20% more in savings; for example, your super could increase from $100,000 to $120,000.

Finding a better super product is easy with the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of all simple, low-cost MySuper products. Go to *ato.gov.au/yoursuper* or use the QR code below:

This letter does not take your personal situation into account. You should think about your investment plans and personal situation, including insurance, when switching.

When you have opened a new super product, contact the new fund or use myGov to move your money over.

Your questions answered

What is the annual performance test?

The annual government test checks how much your super product has earned for you (after fees) over the last 9 financial years. It compares your product's earnings with those of a similar product over the same period.

Super funds that fail this test are required to tell you.

You can find out more about super at *moneysmart.gov.au*.

How do I move to a new super product?

The first step is to find a new super product. You should think about your investment plans and personal situation, including insurance, when switching.

You may find it helpful to use the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of simple, low-cost *MySuper products*.

Once you have chosen a new super product, contact the fund to open a new account.

After opening a new account, move your money from your existing one. You can contact the new fund or use myGov to do this. Find out more at *moneysmart.gov.au*

Commented s 47F It would make it more meaningful/impactful to have a comparison point to compare how that member's fee/return stacks up against a top performing fund

There should be a commensurate reflection on a member's net return, not just fee. It would be good to indicate in plain English what the member's net returns were in the last financial year. For example:

You had $50,000 invested with ABC Super MySuper on 30 June 2023, and in the last financial year:

- your investment earnings were $X (after fees and taxes), and
- you paid a total of $500 in fees.

Commented s 47F: Adding something here about superannuation being a long term investment would be prudent, given some failed funds have sent these letters with extra information attached about their short term returns (e.g., one year product level returns) being superior to imply that failing the test wasn't all that bad.

What happens if a product fails two or more years in a row?

If a super product fails the test at least two years in a row, it cannot accept new members until it passes a future test. You should think about the impact of this on the product's ability to improve.

Your money will stay in the failed super product unless you move it.

Commented s 47F : Suggest bolding and including clarification that it is in reference to the product that failed the test

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Non-platform TDP, consecutive failures, one product

Dear John,

Your superannuation product ABC Super High Growth has failed the annual performance test at least 2 years in a row. We are now banned from accepting new members into this product until it passes a future test. You should think about moving your money to a different super product.

The Australian Government tests your super fund's products every year to make sure your savings are well managed for when you retire. Funds that fail this test are required by law to tell you.

You had $50,000 invested in ABC Super High Growth on 30 June 2023 and paid a total of $500 in fees in the last financial year.

Commented s 47F: As above

Your money will stay in ABC Super High Growth unless you move it.

Finding a better super product could be worthwhile for your future. You could save thousands of dollars more for when you retire by switching to a better product. Superannuation is a long-term investment. By earning 1% more each year for 30 years, you could retire with 20% more in savings; for example, your super could increase from $100,000 to $120,000.

Commented s 47F: As above

You may find it helpful to use the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of simple, low-cost *MySuper products*. Note that the products listed above are *not* MySuper products. You should think about whether a MySuper product is right for you. Go to *ato.gov.au/yoursuper* or use the QR code below:

Commented s 47F Is it correct to include this sentence in this version of the letters (ie, one product)?

It could be clearer. For example: "Note that your superannuation product(s) listed in this letter is not a MySuper product."

This letter does not take your personal situation into account. Before switching products, you should think about your investment plans and personal situation, such as investment goals and values, as well as insurance, fee and tax impacts. You may wish to seek financial advice ~~speak to a financial adviser~~ about your personal circumstances if you are unsure.

Commented s 47F: Small clarification that recommends seeking financial advice which could include speaking to a financial adviser but also includes seeking financial advice from other sources.

Your questions answered

What is the annual performance test?

The annual government test checks how much your super product has earned for you (after fees) over time. It compares your product's earnings with those of a similar product over the same period. The test is done at the product level. There may be a range of fees associated with a product. The test does not account for your personal situation, fees or tax.

Super funds that fail this test are required to tell you.

You can find out more about super at *moneysmart.gov.au*.

What things should I consider when deciding to switch super products?

The performance test does not take into account your individual circumstances. You should think about your investment plans and personal situation, such as investment goals and values, as well as insurance, fee and tax impacts, when switching. You may wish to seek financial advice ~~speak to a financial adviser~~ about your personal circumstances.

How can I find a new super product?

You may find it helpful to use the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of simple, low-cost *MySuper products*. Note that the products listed above are *not* MySuper products. You should think about whether a MySuper product is right for you. Go to *ato.gov.au/yoursuper* or use the QR code below:

How do I consolidate my funds?

If you open an account with a new super fund, contact the new fund or use myGov to consolidate your money, saving on fees by avoiding charges on multiple accounts.

What happens if a product fails two or more years in a row?

If a super product fails the test at least two years in a row, it cannot accept new members until it passes a future test. You should think about the impact of this on the product's ability to improve.

Your money will stay in the failed super product unless you move it.

Commented s 47F As above

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Platform TDP (wrap), single failure, one product

Dear John,

Your superannuation product ABC Super High Growth has failed the annual performance test. You should think about moving your money to a different super product.

The Australian Government tests your super fund's products every year to make sure your savings are well managed for when you retire. Funds that fail this test are required by law to tell you.

You had $50,000 invested in ABC Super High Growth on 30 June 2023 and paid a total of $500 in fees in the last financial year.

Commented s 47F : As above

Your money will stay in ABC Super High Growth unless you move it.

Finding a better super product could be worthwhile for your future. You could save thousands of dollars more for when you retire by switching to a better product. Superannuation is a long-term investment. By earning 1% more each year for 30 years, you could retire with 20% more in savings; for example, your super could increase from $100,000 to $120,000.

Commented s 47F : As above

This letter does not take your personal situation into account. Before switching products, you should think about your investment plans and personal situation, such as investment goals and values, as well as insurance, fee and tax impacts. You may wish to seek financial advice ~~speak to a financial adviser~~ about your personal circumstances if you are unsure.

Your questions answered

What is the annual performance test?

The annual government test checks how much your super product has earned for you (after fees) over time. It compares your product's earnings with those of a similar product over the same period. The test is done at the product level. There may be a range of fees associated with a product. The test does not account for your personal situation, fees or tax.

Super funds that fail this test are required to tell you.

You can find out more about super at *moneysmart.gov.au*.

What things should I consider when deciding to switch super products?

The performance test does not take into account your individual circumstances. You should think about your investment plans and personal situation, such as investment goals and values, as well as insurance, fee and tax impacts, when switching. You may wish to seek financial advice ~~speak to a financial adviser~~ about your personal circumstances.

How can I find a new super product?

You may find it helpful to use the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of simple, low-cost *MySuper products*. Note that the products listed above are *not* MySuper products. You should think about whether a MySuper product is right for you. Go to *ato.gov.au/yoursuper* or use the QR code below:

How do I consolidate my funds?

If you open an account with a new super fund, contact the new fund or use myGov to consolidate your money, saving on fees by avoiding charges on multiple accounts.

What happens if a product fails two or more years in a row?

If a super product fails the test at least two years in a row, it cannot accept new members until it passes a future test. You should think about the impact of this on the product's ability to improve.

Your money will stay in the failed super product unless you move it.

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Platform TDP (wrap), single failure, multiple products

Dear John,

You have multiple superannuation products in ABC Super that have failed the annual performance test. You should think about moving your money to a different super product.

The Australian Government tests your super fund's products every year to make sure your savings are well managed for when you retire. Funds that fail this test are required by law to tell you.

You had $100,000 invested in ABC Super on 30 June 2023 and paid a total of $1000 in fees in the last financial year. You had the following invested in failing products:

- Balanced, $50,000
- High Growth, $20,000
- Sustainable, $30,000

Commented s 47F : As above

Your money will stay in these failing products in ABC Super unless you move it.

Finding a better super product could be worthwhile for your future. You could save thousands of dollars more for when you retire by switching to a better product. Superannuation is a long-term investment. By earning 1% more each year for 30 years, you could retire with 20% more in savings; for example, your super could increase from $100,000 to $120,000.

Commented s 47F : As above

This letter does not take your personal situation into account. Before switching products, you should think about your investment plans and personal situation, such as investment goals and values, as well as insurance, fee and tax impacts. You may wish to seek financial advice ~~speak to a financial adviser~~ about your personal circumstances if you are unsure.

Your questions answered

What is the annual performance test?

The annual government test checks how much your super product has earned for you (after fees) over time. It compares your product's earnings with those of a similar product over the same period. The test is done at the product level. There may be a range of fees associated with a product. The test does not account for your personal situation, fees or tax.

Super funds that fail this test are required to tell you.

You can find out more about super at *moneysmart.gov.au*.

What things should I consider when deciding to switch super products?

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How can I find a new super product?

You may find it helpful to use the Australian Government's YourSuper comparison tool. You can use the tool to compare the fees and earnings of simple, low-cost *MySuper products*. Note that the products listed above are *not* MySuper products. You should think about whether a MySuper product is right for you. Go to *ato.gov.au/yoursuper* or use the QR code below:

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What happens if a product fails two or more years in a row?

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Your money will stay in the failed super product unless you move it.

Commented s 47F **:** As above

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s 22

From: Your Future Your Super
Sent: Tuesday, 2 May 2023 5:05 PM
To: s 47F
Cc: s 47F
Subject: RE: Cbus submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

OFFICIAL

Thank you for your email.

Treasury has received your submission.

Please note that all information (including name and address details) contained in the submission will be made available to the public on the Treasury website unless you have indicated that you would like all or part of your submission to remain in confidence. Please confirm via reply email if there are any aspects of this submission which you would like to remain in confidence.

Kind Regards,

Retirement, Advice and Investment Division

treasury.gov.au
Langton Crescent, Parkes ACT 2600
Twitter | LinkedIn | Facebook

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

LGBTIQ+ Ally

OFFICIAL

From: s 47F @cbussuper.com.au>
Sent: Tuesday, 2 May 2023 3:59 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Cc: s 47F @cbussuper.com.au>
Subject: Cbus submission - Superannuation Performance Test Regulations 2023

To whom it may concern,

Please find attached the Cbus Submission to consultation Superannuation Performance Test Regulations.

If you have any questions regarding the submission, please contact s 47F (cc'd) or myself.

Cbus does not consider the attached submission confidential.

Best regards

s 47F

Phone s 47F
Email s 47F @cbussuper.com.au
Web www.cbussuper.com.au

Director
Members Outcomes and Governance Branch
Retirement Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600

By email: yfys@treasury.gov.au

Exposure Draft Superannuation Performance Test Regulations 2023

Cbus welcomes the opportunity to comment on the Superannuation Performance Test Exposure Draft Regulations and Explanatory Materials.

About Cbus

Cbus Super was established in 1984, created by workers for workers. We are a proud industry super fund, representing those that help build Australia.

As one of Australia's largest super funds, we provide superannuation and income stream accounts to more than 875,000 members and manage over $73 billion of our members' money (as at December 2022). Cbus is a top performing fund and has a long history of strong returns, with an average annual retorn over the last 38 years of 8.88%[1].

The Fund has a history of investing back into our community – supporting industries that are important to our members and creating better retirement outcomes. By acting as a direct investor on our member's behalf, the Fund is a provider of significant capital to businesses around Australia. This funding will help to strengthen the Australian economy and drive higher returns for our members.

[1] As at 30 June 2022 for the Growth (MySuper) option and based on the crediting rate.

Performance test methodology

Cbus supports the role of the performance test in addressing underperformance within the superannuation sector and welcome the proposed changes that fix flaws in the methodology and ensures that the benchmarks are better aligned with how funds actually invest.

In particular we support:

- The inclusion of emerging market equities benchmarks - given this is often a standalone asset allocation with its own risk/return profile compared to developed market equities.
- Changes to unlisted infrastructure benchmark - the proposed change should better represent the profile of a traditional core infrastructure portfolio and be more representative of the index constituents.
- Longer term period - The proposed 10-year timeframe would better align to how superannuation funds actually invest and ensure alignment with other disclosures to members such as investment return objectives and MySuper Dashboard requirements.
    - Given the proposed performance history time horizon is being extended by 2 years – we also suggest that the minimum testing time horizon requirement for new products is also extended by 2 years, from 5 years to 7 years. This would better align with the long term nature of superannuation, noting that 5 years is a very short time period in the context of members have multiple decade superannuation holdings and funds typically targeting investment objectives over rolling 10 year periods.
- Immediate application of proposed benchmark changes – given the proposed benchmark changes address clear shortcomings in the performance test, we support the approach that the proposed benchmarks apply when assessing historical performance. It is also noted that due to recent changes to data reporting requirements we do not expect there to be a need for extensive resubmission of previous data, given that more granular asset allocation data was already provided to APRA last year.

Administration fees

Cbus does not support the administration fee component of the performance test continuing to be based on the most recent financial year. We believe that any assessment of net performance must be reflective of the actual fees charged to members at the time and ultimately the actual net return that a representative member would have received. In its current form the performance test is misleading, inconsistent and most importantly does not reflect actual member outcomes.

Whilst we appreciate the intention of the change was to incentivise funds to reduce administration fees, we believe that misrepresenting historical net returns is not the best way to encourage funds to reduce administration fees.

Granular benchmarks

Whilst Cbus supports the proposed addition of these further benchmarks, and we are comfortable on balance with what has been proposed in the draft regulations, our strong preference would be that there are not ongoing changes to benchmarks, which creates uncertainty and inconsistency. In this regard, further changes should be very limited or ideally not at all in our view. Finally, we believe that the inclusion of further benchmarks beyond these will just create more complexity and potential inconsistency in how different funds assigns their asset classes and sub asset classes.

As noted in our earlier submissions we also believe that the performance test could be revamped to capture SAA construction and consideration could be given to the use of a simple naïve 70/30 reference portfolio. This would significantly simplify the process for the regulator and would also avoid the various issues that can occur with how different funds classify investments and the selection of benchmarks made for the test. In addition, it would better acknowledge that the construction of the SAA is a core and critical function that ultimately drives a significant portion of members' long-term returns.

Cbus also has concerns regarding the proposed International Unlisted Property Index [MSCI Global (Excl. Pan-Europe and Pan-Asia Funds) Quarterly Property Fund Index (Unfrozen) (Net Total Return; AUD fixed). We support the AIST position of deferring implementation of an International Unlisted Property Index until a more representative index can be formulated and are concerned about the practice of a new benchmark as we understand it is being effectively created from scratch less than three months before the end of the financial year with limited or no industry input.

Recommendation: Administration fees should reflect actual administration fees incurred at the time

Recommendation: The performance test should be revamped to capture the SAA construction. Consideration could be given to a simple naïve 70/30 reference portfolio as one way of achieving this aspect

Recommendation: Consider the incorporation of other metrics in the performance test, for example those that capture risk and consistency more explicitly

Recommendation: Consider the use of a secondary risk-based assessment if a product fails the initial quantitative test

Recommendation: Consider extending the minimum testing time horizon requirement for new products by 2 years, from 5 years to 7 years

Recommendation: Defer the implementation of an International Unlisted Property Index until a more representative index can be formulated

Consequences of failure

Given that any performance test when applied across an entire industry is likely to have imperfections and limitations, consideration should be given to how a fund is ultimately considered to have failed and the consequences which are applied.

One additional option is a secondary risk-based assessment for funds which fail the initial quantitative test. This secondary risk-based assessment could be a more sophisticated assessment and could consider a broader set of information including any additional context to the drivers of the outcome and any forward-looking considerations.

This approach would better identify persistent underperformance and provide a basis for legislating stronger consequences for funds which fail both stages of the test – ensuring the members are not left to languish in underperforming legacy products. The current approach – which relies on members actively switching out of underperforming funds does nothing to protect disengaged existing members that do not switch out of underperforming products.

Notification letter

Cbus supports the proposed changes to the mandatory content information within the trustee notification to beneficiaries upon failing the performance test. Given the importance of insurance within superannuation, particularly for those working in hazardous occupation, it is important that at a minimum the letter encourages members to consider the consequences that switching funds may have on their insurance benefits.

It is also appropriate that the prescribed form of the mandatory member notice reflects the different consequences of failing a second consecutive test.

We remain concerned however a fund that is in the process of merging with a larger, high performing fund, cannot modify (or receive relief) to the prescribed wording in the underperformance notification to include information about the merger and explain what it means for the member.

Recommendation: When sending an 'underperformance letter' the fund should be able to include information about a proposed merger. Alternatively, funds that have agreed to a merger should potentially be able to receive an exemption from sending the letter, accordingly APRA should be given the powers to consider an exemption request on a case-by-case basis.

Recommendation: The consequences of failing to meet the proposed performance benchmark must be strengthened to protect disengaged existing members and avoid a new generation of members being left to languish in underperforming legacy products

Product coverage

Cbus supports the extension of the performance test to Trustee Directed Products but continue to be concerned that most of the Choice segment is not included in the performance test, despite repeated findings that this is where many of the worst member outcomes occur. Most recently, the 2023 APRA Choice Heatmap found that one in five Choice investment options significantly underperformed their benchmarks by more than 0.5% and over 40% underperformed against their benchmarks[2]. This is likely an underestimation given the heatmap only covers 47% of funds under management in the Choice accumulation sector and does not cover the retirement sector.

Recommendation: The amended performance test should apply to all superannuation products (including retirement products), as recommended by the Productivity Commission. Further consultation is required on how the performance test should apply to certain retirement products (such as longevity products)

[2] https://www.apra.gov.au/news-and-publications/apra-increases-transparency-of-choice-super-products-latest-heatmap

s 22

From: Your Future Your Super
Sent: Wednesday, 3 May 2023 12:30 PM
To: s 47F
Cc: Your Future Your Super
Subject: RE: Submission - YFYS Performance Test Draft Regulations [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

Thank you for your email.

Treasury has received your submission.

Please note that all information (including name and address details) contained in the submission will be made available to the public on the Treasury website unless you have indicated that you would like all or part of your submission to remain in confidence. Please confirm via reply email if there are any aspects of this submission which you would like to remain in confidence.

Kind Regards,

Retirement, Advice and Investment Division

treasury.gov.au
Langton Crescent, Parkes ACT 2600
Twitter | LinkedIn | Facebook

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

LGBTIQ+ Ally

OFFICIAL

From: s 47F @rest.com.au>
Sent: Tuesday, 2 May 2023 7:48 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Subject: Submission - YFYS Performance Test Draft Regulations

Dear team,

Thank you for the opportunity to provide a response on the draft regulations regarding changes to the Annual Performance Test. Please let me know if you have any questions or wish to discuss further,

Regards,
s 47F
Regulatory and Technical Services
m. s 47F | rest.com.au |
Gadigal Country, Level 5, 321 Kent Street, Sydney NSW 2000


Fair is helping every Aussie get ahead in super
Rithe & Lachie,
Rest members

2 May 2023

Director
Members Outcomes and Governance Branch
Retirement Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600

By email: YFYS@treasury.gov.au

Submission – Draft Regulations – Superannuation Performance Test

Thank you for the opportunity to provide a response to the proposed Superannuation Performance Test Regulations 2023.

Rest is supportive of measures that seek to ensure that the retirement savings of Australians are well-managed in high-performing funds. We note, however, that the proposed regulations fail to address many of the significant problems with the performance test that was raised by our, and other participants', response to the *Review of Your Future, Your Super Measures* consultation.

We remain of the view that, even if amended as proposed by the regulations, the performance test:

- does not appropriately address high-performance, transparency and comparability across the superannuation system,
- continues to distort actual net benefits delivered to members, through the approach to fees, and
- continues to adversely affect investment decisions and limit investments in certain assets and asset classes, including potential nation-building assets.

If the test is to be extended beyond default MySuper products, we consider that it should extend to all investment options, not just those that are "trustee directed products". If the performance test only applied to the default options, the consumer protection rationale of the test is clear: additional protections for members who may not actively choose the default option. However, once extended into choice products, the rationale for including only investment options with allocations across multiple asset classes is unclear. The performance test focusses on the efficiency of implementation of investments against specified benchmarks (which is common to all investment options) whereas the "trustee directed products" definition only applies to investment options with multiple asset classes (the efficacy of which is not tested under the performance test).

Having said that, we consider that the "one-size-fits-all" design of the performance test is significantly challenged when extended beyond the default MySuper products. This is because choice products may have been deliberately designed for members who want:

- a shorter or longer time horizon frame than the lookback period specified in the annual performance test. We note that Rest's membership is diverse – with those nearing retirement focussing on options with a shorter investment horizon than the lookback period, and those entering the working force having a much longer investment horizon than the lookback period; and/or

- an investment portfolio that diverges from the asset class benchmarks specified in the performance test. We note that a significant proportion of Rest's membership has chosen an investment option that expressly focusses on sustainability themes.

The design of such investment options is disclosed to members in the *Product Disclosure Statement*, and otherwise, prior to members choosing those investment option(s). It would be possible to design a performance test that better assesses performance against the disclosed design intention of investment options. Such a test would accord better with Fund's existing design and distribution, and disclosure, obligations.

We remain concerned about the distorting effect of the use of only the most recent relevant administration feed and expenses (RAFE) in metrics used in the performance test. Use of only the most recent RAFE inaccurately reflects the benefit that has been delivered to members in previous years, and this should be amended to reflect the RAFE relevant to each year of performance to prevent this distortion effect.

Given the noted challenges of the design of a universally appropriate test across the superannuation system, we also continue to maintain that there is opportunity to reconsider the consequences of the failure of the performance test, and tailor them to the circumstances. Rest continues to support a multi-step or flexible approach to performance test failure that appropriately addresses the matters that led to the result. This may include specific APRA oversight of the planning steps that a fund is taking to address the underperformance, or assistance to find an appropriate merger partner, if that is deemed to be the desired outcome.

Our comments in relation to particular matters raised by the proposed regulations are set out in the Appendix.

To discuss any aspect of this submission, I invite you to contact Sarah O'Brien, General Manager, Regulatory and Technical Services directly on 0400 399 330 or via email on sarah.o'brien@rest.com.au.

Yours sincerely,

Vicki Doyle
CEO

Appendix - Comments on Superannuation Performance Test Draft Regulations

Test period

Different investment options are designed and distributed for different investment periods. A single lookback period is inappropriate for all products.

We note that the when the lookback period was 8 years, the test would only (usually) apply once an investment option had a 5 year performance record. The effect of this was that an underperforming investment option couldn't be closed to new members until its 6th year at which time it had a performance record equivalent to 75% of the lookback period. As the stated intention of the extension of the lookback period is to "sharpen the incentive of trustees to focus on long-term decision making"[1], it seems inappropriate to retain the relatively shorter 5th full year as the threshold for the first assessment when a 10 year lookback period applies. For a 10 year lookback period, a threshold of 7 full years' performance seems more appropriate.

Recommendations

- The lookback period should be 10 years, or if shorter, reflect the investment period for which a product is designed.
- The performance test should not be applied to enable an investment product to be closed until it has had a performance record equivalent to 75% of its lookback period.

Administration fees

The proposed Regulations maintain the approach to calculating the "actual" RAFE based on the most recent financial year. This continues to distort the performance test away from the actual net benefit delivered to members by retaining the existing inaccurate / manufactured basis of calculation. An approach to administration fees and costs which better aligns to the actual net benefit delivered to members across the entire lookback period better promotes transparency and comparability across the superannuation industry, while still providing an impulse to sustainably reduce administration fees and costs into the future.

Recommendation

- The actual RAFE should be the administration fees and costs paid by a member across the entire lookback period, rather than just the administration fees and costs in the last financial year.

[1] Exposure Draft Explanatory Memorandum, page 2

Benchmarks

We note that the effect of the proposed Regulations is to retrospectively apply new benchmarks for the entire test period (ie from 1 July 2014 onwards) across new compositions of (sub)asset classes and utilising new data sets.

This approach is problematic because:

- it is inconsistent with the stated rationale for the performance test to "seek to ensure that superannuation products have their performance assessed against an objective, consistently-applied benchmark"[2]. Significant changes to benchmarks and groups of assets that apply retrospectively cannot be said to be either objective nor consistently applied;

- the rationale of assessing performance against benchmarks is to identify the benefit or determinant of investing differently to the benchmark. That presupposes that the benchmark is investible and is known at the time the investment decision is made. We note that some of the proposed benchmarks continue to be uninvestable. We also note that it is inconsistent with that rationale to retrospectively apply new benchmarks to different compositions of assets, given that investment decisions were made in view of the then applicable benchmarks to particular assets. This is particularly notable given that the proposed benchmark for International Unlisted Property did not exist prior to the publication of the proposed Regulations. Any comparison to an uninvestable benchmark is arbitrary; a better test for the relevant asset classes would be a benchmark which reflects the intention of that asset class's contribution to the product objective (eg, a CPI+ target);

- it represents a significant change in methodology and benchmarks, which may result in funds who had failed then passing on new methodology and benchmarks (and vice versa). Such significant amendments to a test with significant punitive consequences should not be considered to have a "minor regulatory impact" only.

Recommendation

- Any changes to benchmarks and the (sub)asset classes they apply to should only be prospective.

- Benchmarks should either be investible or reflect the product's investment objective.

Alternative asset class

The approach to alternative assets continues to be problematic. The alternative asset classes are designed to be uncorrelated (or lowly correlated) to equity and fixed interest returns. Accordingly, it would be better tested against an investment option's investment objective rather than the equity and fixed interest benchmarks (in whatever proportion applies to the new classification of Alternative strategies).

---

[2] Explanatory Memorandum to the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*, paragraph [2.2] page 15

Recommendation

- The benchmark for the alternative asset class should be the investment option's investment objective.

Tax assumptions for Australian equities

The benchmark for Australian equities continues to assume a 0% tax rate. The rationale for this approach appears to be that the tax expense of this asset class should, across the long term, approximately equate to the value of franking credits received. However, for this assumption to be correct over the lookback period, there would effectively need to be an equal number of years where there are no capital gains ("down years") and those where there are ("up years"). If this is not the case, the tax effect can result in a material difference between the benchmark return and the return generated from an efficient passive implementation. This is inconsistent with the rationale of the performance test.

Recommendation

- The Australian equity benchmark should be the S&P/ASX 300 grossed up by the value of the franking credits with the same tax rate assumptions as are applied to other asset classes.

Currency

The proposed amendments to Regulation 9AB.5 allow product-level currency hedging ratios to be imputed across asset classes with an international domicile. This amendment calculates a currency hedging ratio as one minus the option-level foreign currency exposure divided by the sum of the strategic asset allocation to all internationally domiciled assets. The resultant hedge ratio is then applied across all asset classes with an international domicile (whether the benchmark is hedged or not). This approach is flawed as it applies a hedging ratio across internationally domiciled asset classes that do not have foreign currency exposure in their benchmark.

Recommendation

- Where foreign currency exposure is reported at the product level, calculate the currency hedging ratio as the product-level foreign currency exposure divided by the sum of allocations to asset classes that have an international domicile with an unhedged benchmark (i.e. the covered asset classes identified in items 2, 3, 4, 5, 6 and 7 of the table in regulation 9AS.17).

s 22

From: s 22
Sent: Thursday, 11 May 2023 10:08 AM
To: s 47F (AustralianSuper - Unclassified); s 47F
Cc: s 22
Subject: RE: AustralianSuper submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

OFFICIAL

Thanks s 47F

I'm just in a meeting at the moment but will be free to chat after 10:30. What is s 47F best contact number?

Cheers,
s 22

OFFICIAL

From: s 47F @australiansuper.com>
Sent: Thursday, 11 May 2023 10:06 AM
To: s 22 @TREASURY.GOV.AU>; s 47F Australian Super - Unclassified) s 47F @australiansuper.com>; s 47F @australiansuper.com>
Cc: s 22 @treasury.gov.au>; s 22 @TREASURY.GOV.AU>; s 22 @TREASURY.GOV.AU>
Subject: RE: AustralianSuper submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

Hi s 22

I just tried to call you. s 47F is available to discuss this today between 10 and 2pm.

Is there a time that works for you?

Regards
s 47F

From: s 22 @TREASURY.GOV.AU>
Sent: Wednesday, 10 May 2023 12:26 PM
To: s 47F @australiansuper.com>; s 47F @australiansuper.com>
Cc: s 22 @treasury.gov.au>; s 22 @TREASURY.GOV.AU>; s 22 @TREASURY.GOV.AU>
Subject: RE: AustralianSuper submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

Some people who received this message don't often get email from s 22 @treasury.gov.au. Learn why this is important

OFFICIAL

Hi s 47F

Hope you're well. I'd be interested in discussing Attachment A of AustralianSuper's submission regarding the international unlisted property benchmark. Would you be free for a quick phone call after 4:30pm today, or alternatively in the morning tomorrow?

Thanks,

s 22 — **Analyst, CBR**
Superannuation Efficiency and Performance Unit, Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
s 22

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

OFFICIAL

From: s 47F @australiansuper.com>
Sent: Tuesday, 2 May 2023 5:24 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Cc: s 22 @treasury.gov.au>; Spear, Luke <Luke.Spear@treasury.gov.au>; s 47F @australiansuper.com>
Subject: AustralianSuper submission - Superannuation Performance Test Regulations 2023

Please see attached.
Regards

s 47F
Strategy, Reputation & Corporate Affairs
P: s 47F
australiansuper.com

AustralianSuper

This email may contain general financial advice which doesn't take into account your personal objectives, financial situation or needs. Before making a decision, consider if the information is right for you and refer to the relevant Product Disclosure Statement, available at australiansuper.com/pds or by calling 1300 300 273. A Target Market Determination (TMD) is a document that outlines the target market a product has been designed for. Find the TMDs at australiansuper.com/tmd
The information contained in this email communication may be confidential. If you've received this email in error, please notify the sender by return email, delete this email and destroy any copy. Any personal information you provide to AustralianSuper (including its related bodies corporate and subsidiaries) will be collected, stored and otherwise dealt with in accordance with AustralianSuper's Privacy Policy as amended from time to time and available at

australiansuper.com/privacy-policy
AustralianSuper Pty Ltd, ABN 94 006 457 987, AFSL 233788, Trustee of AustralianSuper ABN 65 714 394 898.

s 22

From: s 47F @cbussuper.com.au>
Sent: Friday, 12 May 2023 12:48 PM
To: s 22
Cc: s 22
Subject: RE: Cbus submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

Hi s 22

Thanks for your time on the phone yesterday.

Further to our discussion, I can confirm that our view is that the current *MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index – NAV-Weighted Post-Fee Total Return (All Funds)* should continue to be used as the international unlisted property benchmark, given the issues raised with the proposed index and that a new index should be subject to further industry consultation.

As noted we don’t have significant concerns regarding assumed annual fees however on the credit fees, we think the assumed annual fee is probably too low and for global high yield in particular should be closer to at least 40bps. For Australian credit perhaps closer to 15-20bps.

Noting that for the global high yield index, the iShares Global High Yield Bond (AUD Hedged) ETF costs 0.56% as an example. Screen shot below.

Happy to chat if any further questions.

Best regards

s 47F Policy and Advocacy

Phone s 47F
Email s 47F @cbussuper.com.au
Web www.cbussuper.com.au

From: s 22 [redacted]@TREASURY.GOV.AU>
Sent: Thursday, 11 May 2023 11:30 AM
To: s 47F [redacted]@cbussuper.com.au>
Cc: s 22 [redacted]@TREASURY.GOV.AU>; s 22 [redacted]@treasury.gov.au>; s 22 [redacted]@TREASURY.GOV.AU>
Subject: RE: Cbus submission - Superannuation Performance Test Regulations 2023 [SEC=OFFICIAL]

OFFICIAL

Hi s 47F [redacted]

Apologies for missing your call earlier, I was hoping to chat about Cbus' view on the international unlisted property benchmark. Could you give me a call on s 22 [redacted] when available?

Cheers,

s 22 [redacted] — **Analyst, CBR**
Superannuation Efficiency and Performance Unit, Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
s 22 [redacted]

The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

OFFICIAL

From: s 47F [redacted]@cbussuper.com.au>
Sent: Tuesday, 2 May 2023 3:59 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Cc: s 47F [redacted]@cbussuper.com.au>
Subject: Cbus submission - Superannuation Performance Test Regulations 2023

To whom it may concern,

Please find attached the Cbus Submission to consultation Superannuation Performance Test Regulations.

If you have any questions regarding the submission, please contact s 47F [redacted] (cc'd) or myself.

Cbus does not consider the attached submission confidential.

Best regards

s 47F [redacted] Policy and Advocacy

Phone s 47F [redacted]
Email s 47F [redacted]@cbussuper.com.au
Web www.cbussuper.com.au

s 22

From:	s 47F @australiansuper.com>
Sent:	Thursday, 20 April 2023 6:13 PM
To:	Spear, Luke
Cc:	s 47F (AustralianSuper - Unclassified); s 22
Subject:	RE: Meeting request on YFYS benchmarks [SEC=OFFICIAL]

Thanks Luke.

I think we can be more forthright in a bilateral. It will need to be Teams or Zoom next week.

Thanks
s 47F

From: Spear, Luke <Luke.Spear@treasury.gov.au>
Sent: Thursday, 20 April 2023 5:14 PM
To: s 47F @australiansuper.com>
Cc: s 47F @australiansuper.com>; s 47F @australiansuper.com>; s 22 @treasury.gov.au>; s 22 @TREASURY.GOV.AU>
Subject: RE: Meeting request on YFYS benchmarks [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

I think s 47F is coming along to a meeting tomorrow, but happy to have a bilateral with you next week if you want.

We are free 10-11am or 4.30-5pm on Wed if that suits,

luke

Luke Spear — **Assistant Secretary**
Member Outcomes and Governance Branch
P +61 2 6263 2959 M +s 22

OFFICIAL

From: s 47F @australiansuper.com>
Sent: Thursday, 20 April 2023 1:52 PM
To: Spear, Luke <Luke.Spear@treasury.gov.au>
Cc: s 47F Australian Super - Unclassified) s 47F @australiansuper.com>; s 47F @australiansuper.com>
Subject: Meeting request on YFYS benchmarks

Hi Luke.

I hope you are well.

I realise you are doing some consultation work around the industry associations on the YFYS benchmarks.

Separate to that we were hoping for catchup on it. I want to bring s 47F who participated in the technical/expert discussions that you coordinated. We have feedback and want understand unintended consequences versus a policy decision.

This will help inform our submission.

Kind regards
s 47F

Acting Head of Government Relations & Public Policy
Strategy & Corporate Affairs
M: +s 47F
australiansuper.com

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AustralianSuper Pty Ltd, ABN 94 006 457 987, AFSL 233788, Trustee of AustralianSuper ABN 65 714 394 898.

s 22

From: Your Future Your Super
Sent: Friday, 16 December 2022 10:31 AM
To: Your Future Your Super
Subject: YFYS review - Technical Working Group meeting notes [SEC=OFFICIAL]
Attachments: c2022-313936-working-group-meeting01.pdf; c2022-313936-working-group-meeting02.pdf; c2022-313936-working-group-meeting03.pdf

OFFICIAL

Good morning,

We would like to thank you again for your participation in the Technical Working Group for the YFYS Review.
Please see attached summary notes from the three Technical Working Group meetings.
These notes will be published on the YFYS Review consultation website shortly.

Regards,

YFYS Review Secretariat
YFYS@treasury.gov.au

OFFICIAL

Australian Government
The Treasury

YFYS Review

Technical Working Group Meeting 1 – Summary Note

The first technical working group meeting on the performance test was held on 29 September 2022. This meeting clarified the purpose of the group in the context of the Your Future, Your Super review. Treasury iterated that the purpose of the group is not to advise the Government directly, or make decisions, but provide advice to Treasury for consideration. The group discussed topics within the existing structure of the performance test.

High-level concerns and potential solutions

Each member identified three primary concerns they have with the current performance test and proposed three potential solutions. The dominant concerns heard were:

- Benchmarks
  - Specific concerns were raised about benchmarks for unlisted property and infrastructure, alternatives, environmental social and governance (ESG), emerging markets, credit and fixed income. Either relating to the insufficiencies of the index selected for an asset class, or the asset class itself being too broad.
  - It was expressed that some current benchmarks are too narrow and discouraging diversification in investment portfolios due to a necessary increase in tracking error. This is disincentivising long-term investment strategies that are ultimately in the best interests of members.
- Length of the lookback period
  - Some argued the eight-year horizon is too short and encouraging short-termism in investment decisions and inhibiting innovation.

- The test only assesses ‘implementation’
  - It measures the implementation of a fund’s strategic asset allocation (SAA) without an assessment of the asset allocation strategy itself.
  - The value added by fund managers cannot be captured by only assessing implementation.
- The lack of multiple metrics or qualitative oversight to capture additional performance information which could minimise unintended consequences.
  - Examples included risk-adjusted returns as an assessment of both the investment strategy and implementation. Several models were raised by members with no clear consensus of views on what models may be most suitable, given all have advantages and disadvantages.
- Other concerns included the expansion of the test to Choice products, the calculation of representative administration fees and expenses (RAFE) and benchmark representative administration fees and expenses (BRAFE) and the severity of consequences for failure.

Some of the potential solutions proposed were:

- The inclusion of more granular benchmarks within asset classes:
  - This would help control for intra-asset class risk and help reduce fund tracking error for investment in assets not included in the existing benchmarks.
  - There was recognition that the inclusion of additional benchmarks is a balancing act, as there are no clear signals on where to draw the line on intra-asset class benchmarks.
- Expanding the test’s lookback period to reduce fund short-termism and the weight of each individual year in the test.
- Additional metrics or tests as part of the overall fund performance evaluation, such as Australian Prudential Regulation Authority (APRA) qualitative oversight or risk adjustment of returns.
- Expanding the spectrum of consequences for Choice products, for when the test expands to include them.

Treasury also noted that consideration will be required to the legislative process for enacting changes.

Lookback period

The eight-year lookback period was discussed in the context of contributing to short-termism in investment decision-making, at the cost of disincentivising investments which generate value over the long-term which are more likely to improve member outcomes. There was general feedback from members that increasing the lookback period would help reduce this unintended consequence, but that there were trade-offs to increasing the number of years.

- Increasing the lookback period would have the effect of diluting each individual year in the performance test. Therefore, a longer lookback period would improve consistency of results and become a more reliable indicator of how a fund has implemented its SAA over time.
- However, an increase in the time horizon would also reduce the test's ability to accurately evaluate funds on their current performance, or reflecting changes in investment governance. As additional years of past performance get included, the weight of recent results becomes less impactful. Where funds adjust internal processes and investment strategies to improve poor performance, this will not impact the test as much with a longer lookback period.

Many members proposed a ten-year horizon to be a favourable alternative time horizon.

- 10 years is consistent with the design of MySuper dashboard and PDS horizon. Additionally, a lot of asset allocation modelling is based on the same time period. Potential alignment here was viewed favourably by members.
- However, some members stressed that an expansion to ten years, while impactful, was not sufficient to reduce short-termism on its own.

Members proposed that any expansion in the time period should be incremental, with an increase of one year at a time instead of all at once.

- Issues of data quality from beyond eight years ago were raised as a constraint to introducing all years at once.
- The group supported aligning the lookback period of Choice and MySuper products.

Members briefly raised consideration for a ten-year lookback period as two separate five-year periods.

- The difficulty around understanding the unintended consequences of such a move were emphasised in response.

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Technical Working Group Meeting 2 – Summary Note

The second technical working group meeting was held on 6 October 2022. This meeting began with Treasury clarifying the objective of the performance test. The discussion then centred on benchmarks, with consideration of benchmark selection principles as well as specific benchmarking issues within the current test.

Policy objective of the performance test

Treasury clarified that:

- The primary objective of the test is to remove underperforming products.
- Other complementary objective were to reduce fees, improve performance, encourage sector consolidation, and improve regulator and fund accountability.

Members broadly agreed with this overall policy objective, with some unintended consequences raised regarding second-order impacts on well-performing products and funds from the current test.

Benchmark principles

Members responded well to the following principles outlined in the pre-circulated discussion note:

- Broad and representative
- Investable
  - There was recognition that unlisted assets, by definition, cannot satisfy this principle. However, if the unlisted benchmark were broadly representative of fund exposure then it was felt by most members that inclusion would be appropriate.

Additional suggestions by members on principles included:

- Index data should be transparent and free for trustees to access
- "Specified advantage" which suggests avoiding unfrozen indices
- Any benchmark changes should be made on a prospective basis – trustees and APRA shouldn't have to rely on old data for new benchmarks.

Several members were aligned in their views on the need to ensure benchmarks are reviewed on a regular basis. This was seen to be important to:

- Encourage ongoing product innovation
- Enable to sector to be dynamic and reactive to market trends, particularly around ESG and climate-based solutions

Benchmarks

Unlisted assets (property and infrastructure)

- Concerns were raised regarding the current unlisted infrastructure benchmark. Some considered it to be a factor in inhibiting investment in unlisted infrastructure.
  - Raised issues included: the unfrozen nature of the index; no distinction between domestic and international.
  - Members recognised there is currently a working group at MSCI tasked with fixing the infrastructure benchmark.
  - Members suggested alternatives included EDHEC Infra 300, but there was no uniform views on whether an alternative index would be better, on balance, than the current benchmark.
- Some members mentioned a separate private equity benchmark may be prudent, however recognised this would be difficult due to the different investment categories which comprise private equity.

Fixed income

- Members broadly proposed that more granularity in fixed income would help reduce unintended consequences of unsustainable tracking error, and potential false positives of defensive Choice products.
- Some suggestions included splitting the index into short and long duration, however there was no consensus on method to defining each duration. Some members highlighted a need to create a credit benchmark, and an inflation-linked bond benchmark.

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Technical Working Group Meeting 3 – Summary Note

The third technical working group meeting was held on 13 October 2022. This meeting continued the benchmark discussed from the previous week, as well as covering fees, product coverage and broader issues.

Benchmarks

Potential unintended consequences and possible solutions for the following key benchmarks were discussed:

Alternatives

- Concerns were raised regarding the 50/50 bond and equities split used to measure the current alternatives benchmark. Some members argued the existing benchmark disincentivises investment in alternatives, and the associated benefits of diversification and volatility reduction, through the necessary increase in tracking error.
- Some members provided the following suggestions:
  - Breaking alternatives into a growth index and defensive index.
  - A 'cash + x-per-cent', or 'CPI + x-per-cent' benchmark to replace the current calculation.

International equities

- The members suggested the benchmark to be split into emerging market and developed market indices.

Environmental, social, governance (ESG)

- Some members of the group expressed desires for the introduction of an ESG benchmark, to reduce tracking error faced by values-based products.
- Difficulties were raised on benchmark selection, particularly on whether any existing benchmarks are suitable and well-defined to measure industry performance in this space.

Fees

The group discussed the existing 12-month fee lookback period. Some highlighted benefits centred on the immediate incentive it provides funds to reduce fees, which has been demonstrated in the market.

Regarding the extension to Choice, there was broad agreement that the segment requires fees to be tested however some concerns were raised regarding the complexity of some Choice products. In particular, wrap/platform products apply fees differently depending on the options included in that product.

- One potential solution briefly proposed by members was a separate, fee-based test isolated from the performance test to account for more complex fee structures.

Product coverage

The group raised several concerns regarding the extension to Choice products, which is legislated to commence with trustee-directed products (TDPs) in 2023. These included:

- The unintended consequences in MySuper will become magnified once the test moves to more concentrated Choice portfolios.
- Ambiguity regarding the definition of a TDP may lead to some single-sector products being captured and returning false positives.
- Some TDPs are controlled by a connected entity without the input of trustees. This will prevent trustees from improving product performance in the case of poor test results.

A prominent suggestion proposed by members was to delay or halt the extension to Choice products, however the group recognised this may not be achieve other policy goals. Others suggested:

- Adjusting consequences of test failure for Choice products, in particular removing the failure consequence and limiting to disclosure for members.
- Making disclosure notice for Choice members in case of failure more nuanced.
- Increasing the failure threshold from -50 basis points to -200 basis points.

Broader issues

The group discussed ideas relating to more fundamental design and methodological changes to the performance test.

- Some supported the maintenance of an objective bright-line test, with the inclusion of supplementary quantitative metrics such as risk-adjusted returns. A multi-metric test, using the Australian Prudential Regulation Authority (APRA) heatmap as a starting point, was proposed by some.
- Others expressed that there was a role for APRA to play in applying qualitative discretionary oversight to better understand causes of failure.

s 22

Subject: re: AustralianSuper | Treasury meeting performance test regulations [SEC=OFFICIAL]
Location: Microsoft Teams Meeting

Start: Thu 27/04/2023 1:00 PM
End: Thu 27/04/2023 2:00 PM
Show Time As: Tentative

Recurrence: (none)

Meeting Status: Not yet responded

Organizer: s 47F
Required Attendees: s 47F Australian Super - Unclassified); s 22 ; s 47F ; s 22 Spear, Luke; s 22

Hi s 47F ,
Sorry that time didn't end up working for you.
Hopefully this new time at 1pm Thursday is better.
s 22

Microsoft Teams meeting

s 47E(d)

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---

s 22

From: s 22
Sent: Monday, 18 December 2023 4:09 PM
To: s 22
Subject: FW: Meeting with Industry Super Australia [SEC=OFFICIAL]

OFFICIAL

OFFICIAL

From: Spear, Luke
Sent: Tuesday, 30 May 2023 5:06 PM
To: s 47F @industrysuper.com>
Cc: s 22 @treasury.gov.au>
Subject: RE: Meeting with Industry Super Australia [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

Always happy to chat, we are free 11-12am on the 14th if that suits.

I will also invite s 22 who is managing that workstream,

luke

Luke Spear — **Assistant Secretary**
Member Outcomes and Governance Branch
P +61 2 6263 2959 **M** +s 22

OFFICIAL

From: s 47F @industrysuper.com>
Sent: Monday, 29 May 2023 11:18 AM
To: Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: Meeting with Industry Super Australia

Dear Luke

s 47F is currently on leave but has asked if I could seek your availability for a meeting with himself and s 47F re the Government's response to the YFYS review. Do you have any time available for a Teams meeting in the morning of 14 June?

Kind regards

s 47F
Level 39, Casselden, 2 Lonsdale Street, Melbourne, VIC 3000
www.industrysuperaustralia.com
Industry SuperFunds website: www.industrysuper.com

ISA supports flexible working hours and for me this means I do not work on Wednesdays.

s 22

From: s 22
Sent: Monday, 18 December 2023 4:03 PM
To: s 22
Subject: FW: YFYS Benchmarks [SEC=OFFICIAL]

Follow Up Flag: Follow up
Flag Status: Flagged

OFFICIAL

From: s 47F @industrysuper.com>
Sent: Thursday, 3 August 2023 1:28 PM
To: s 22 @TREASURY.GOV.AU>; Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: Re: YFYS Benchmarks [SEC=OFFICIAL]

Thanks very much s 22

It was me who missed that one, so thanks very much for the clarification.

Kindest regards,
s 47F

Get Outlook for Android

From: s 22 @TREASURY.GOV.AU>
Sent: Thursday, August 3, 2023 1:24:45 PM
To: s 47F @industrysuper.com>; Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: RE: YFYS Benchmarks [SEC=OFFICIAL]

Hi s 47F

Thank you for your prompt reply.

Apologies, in reviewing the highlighted indices I must have missed that detail. The Minister's June media release announced the Government's intentions to make further updates *following* the exposure draft consultation. This included the intention to retain the Bloomberg Ausbond Composite 0+ Yr Index (**BACM0**), rather than the proposed Ausbond Master index.

Kind regards,

s 22 — **A/g Assistant Director**
Superannuation Efficiency and Performance Unit, Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
P +s 22

treasury.gov.au
Langton Crescent, Parkes ACT 2600
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The Treasury acknowledges the traditional owners of country throughout Australia, and their continuing connection to land, water and community. We pay our respects to them and their cultures and to elders both past and present.

From: s 47F @industrysuper.com>
Sent: Thursday, 3 August 2023 12:36 PM
To: s 22 @TREASURY.GOV.AU>; Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: RE: YFYS Benchmarks [SEC=OFFICIAL]

Thanks very much s 22 appreciate you sending this through.

Another quick question if I may.

APRA finally got back to us today and included:

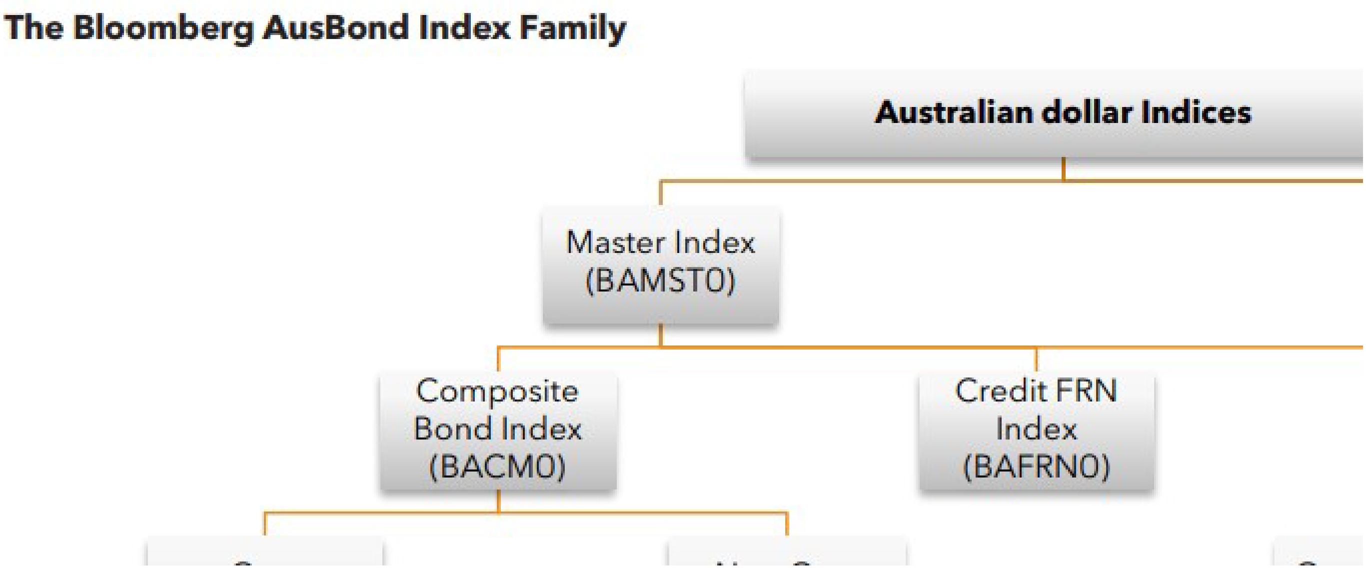
BACM0 Bloomberg Ausbond Composite 0+ Yr Index

for Australian Fixed Income.

The Exposure Draft (attached) appears to have changes this to:

BAMST0 Bloomberg Ausbond Master 0+ Yr Index

I hadn't actually highlighted this in the workbook I sent through as we had the code from the ED, but now given the conflicting advice, can I get confirmation that we should be using the new code (BAMST0), or is this still subject to change?



Kindest regards,
s 47F

From: s 22 @TREASURY.GOV.AU
Sent: Thursday, August 3, 2023 10:46 AM
To: Spear, Luke <Luke.Spear@treasury.gov.au>; s 47F @industrysuper.com>
Subject: RE: YFYS Benchmarks [SEC=OFFICIAL]

Hi s 47F

Apologies for the delayed reply. I have cross referenced against our records and have included ticker codes in the attached worksheet (column G).

I hope this can be of assistance.

Kind regards,

s 22 — **A/g Assistant Director**
Superannuation Efficiency and Performance Unit, Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
P +s 22

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Langton Crescent, Parkes ACT 2600
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From: Spear, Luke <Luke.Spear@treasury.gov.au>
Sent: Wednesday, 2 August 2023 11:59 AM
To: s 47F @industrysuper.com>
Cc: s 22 @TREASURY.GOV.AU>
Subject: FW: YFYS Benchmarks [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

s 22 should be able to help with that,

luke

Luke Spear — **Assistant Secretary**
Member Outcomes and Governance Branch
P +61 2 6263 2959 **M** +s 22

OFFICIAL

From: s 47F @industrysuper.com>
Sent: Wednesday, 2 August 2023 11:40 AM
To: Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: YFYS Benchmarks

EXTERNAL EMAIL: Do not click any links or open any attachments unless you trust the sender and know the content is safe. The active content has been removed from this email.

Hi Luke

I hope this email finds you well.

I am hoping that you or someone in your team may be able to assist with a quick enquiry on the YFYS benchmarks – my colleague s 47F and I have both reached out to APRA separately on this and our enquiries have not been replied to.

The April Your Future, Your Super Exposure Draft added additional asset class benchmarks while the Minister's June press release modified a further 2. We are hoping to get confirmation on the Bloomberg / MSCI tickers for these indices as we engage with Bloomberg on access to ensure we get the correct series. The attached workbook highlights where we are hoping to get confirmation.

I am hoping you may be able to assist or refer us to someone else in APRA as our initially enquiries haven't been fruitful.

Kindest regards,
s 47F

s 47F
s 47F Industry Super Australia
Mobile: s 47F
www.industrysuperaustralia.com

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s 22

From: s 22
Sent: Monday, 18 December 2023 4:09 PM
To: s 22
Subject: FW: YFYS Review Meeting follow up [SEC=OFFICIAL]

Follow Up Flag: Follow up
Flag Status: Flagged

OFFICIAL

From: Spear, Luke
Sent: Friday, 16 June 2023 9:10 AM
To: s 47F @industrysuper.com>; s 22 @treasury.gov.au>
Cc: s 47F Industry Super Funds - Unclassified) s 47F @industrysuper.com>; s 47F @industrysuper.com>; s 47F @industrysuper.com>; s 22 @TREASURY.GOV.AU>
Subject: RE: YFYS Review Meeting follow up [SEC=OFFICIAL]

OFFICIAL

Thanks s 47F

Appreciate the call and your input into this, we will get the team to review and come back to you,

luke

Luke Spear — **Assistant Secretary**
Member Outcomes and Governance Branch
P +61 2 6263 2959 **M** s 22

OFFICIAL

From: s 47F @industrysuper.com>
Sent: Thursday, 15 June 2023 5:01 PM
To: Spear, Luke <Luke.Spear@treasury.gov.au>; s 22 @treasury.gov.au>
Cc: s 47F (Industry Super Funds - Unclassified) s 47F @industrysuper.com>; s 47F @industrysuper.com>; s 47F @industrysuper.com>
Subject: YFYS Review Meeting follow up

Hi Luke, thanks for you and the team's time yesterday to discuss ongoing review of the YFYS framework. Please forward this to s 22 too.

While its still fresh in my mind I wanted to reinforce a few points and reiterate where we will come back to you with further analysis and info.

I've attached our performance assessment submission for reference. We invested a lot of time and resources internally to provide this submission please take the time to have another look. We have also included below the consequences of using differential BRAFE's and selecting median product rather than median member metrics.

Improvement in member outcomes:

- The attached submission considers empirically how the test may have impacted member outcomes:

    - There's no evidence it has lead to a reduction in the spread in performance between products (p6 fig 2);
    - While 40 products reduced fees the median fee reductions was just 15 bps (perhaps sufficient to evade test failure but insufficient to move a member from achieving poor outcomes to materially better ones)
    - Nor has the $ value of fee reductions $410m in 2022 exceeded the $ value of apparent net fee increases $558m (p 20)
- Combined with the absence of member initiated product switching following failure and tendency of failed products to merge with mediocre ones (certainly among retail funds) we think there needs to be a much stronger focus on translating the YFYS objectives into actual outcomes.

Contribution of fees to net return outcomes:

- The attached submission (at page 5 fig 1) deals with the contribution of fees to net return outcomes;
- The spread in administrative fees and expenses accounts for only 50bps difference in net return outcomes, compared to 100bps for total fees, 200bps for the benchmark SAA NIR and over 300bps for actual net return;
- Empirically there is no basis for the weight placed on admin fees and expenses in the test (or total fees for that matter or the comparison tool) given they contribute as little as one sixth and at most one third to actual net returns. Or to put it another way non-fee factors (ie the strategy and execution) contribute the vast majority (2/3rds) or performance outcomes;
- The PC identified there is persistence in outperformance and underperformance. We will provide further analysis following this year's performance tests to reinforce why net returns are a robust metric to inform fund selection.

BRAFE measurement:

- We have consistently pointed to the problems with using median product administrative fees/ expenses rather than fees that are actually representative of the median member;
- Statistical analysis utilising unweighted samples is flawed. In the case of product median fees it ascribes equal weight to products that have few members relative to those that have many it therefore fails to identify typical fees paid by members;
- The fact this metric was utilised in the original regs for MySuper assessment is not an adequate rationale for why it should continue – it results in a much weaker test – especially for choice products that have a long fee tail;
- Based on our analysis of the latest choice heatmap the difference between median product and median member RAFE's is 40bps vs 29bps – that's quite a concession to the high fee tail…
- The continued utilisation of single year ex-ante administrative fees is also flawed. Again, just because this was a feature of the inaugural Mysuper test does not make it an appropriate policy setting;
- Although you may not have been involved at the time it <u>was not consulted on when the exposure draft regulations were originally released</u> – on the contrary, the draft regulations envisaged the use of the full lookback period for administrative fees – in effect treating them in the same way as investment fees and costs.

s 22

Thanks for your time. We will be in touch.

s 47F

s 47F

Phone: s 47F | Mobile: s 47F
Ground Floor, Flex, 4 National Circuit, Barton, ACT 2600
www.industrysuper.com

s 22

From: Your Future Your Super
Sent: Friday, 19 May 2023 10:11 AM
To: s 47F (External - Unclassified)
Cc: Spear, Luke
Subject: RE: Aware Super submission - Performance Test regulations [SEC=OFFICIAL]

OFFICIAL

Thank you for your email.

Treasury is able to accept late submissions and we will add yours to our records. However, as you have noted, the scope to which we can consider submissions in our advice to Government is reduced the later they are received.

Please note that all information (including name and address details) contained in the submission may be made available to the public on the Treasury website unless you have indicated that you would like all or part of your submission to remain in confidence. Please confirm via reply email if there are any aspects of this submission which you would like to remain in confidence.

Kind Regards,

Retirement, Advice and Investment Division

treasury.gov.au
Langton Crescent, Parkes ACT 2600
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OFFICIAL

From: s 47F @aware.com.au>
Sent: Thursday, 18 May 2023 6:04 PM
To: Your Future Your Super <YFYS@TREASURY.GOV.AU>
Cc: Spear, Luke <Luke.Spear@treasury.gov.au>
Subject: Aware Super submission - Performance Test regulations

Good evening,

I've realised that our submission to the YFYS review was inadvertently not sent to Treasury.

I understand you have likely already provided briefing up to the Minister's office, but wanted to provide this for your records anyway. Please let me know if there's anything in this submission that we can provide more information on to assist you at any time.

Kind regards

s 47F

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[redacted]
Policy and Regulatory Reform

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Superannuation Performance Test Regulations 2023

Aware Super Submission

May 2023

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Contents

Executive Summary

Aware Super welcomes the opportunity to provide comment on the proposed changes to the regulations governing the Your Future, Your Super performance test.

We are supportive of the intent of the changes, including the extension of the test to Trustee-Directed Products (TDPs).

However, we are concerned that some of the proposals will not achieve their intent, and require further refinement.

This submission provides recommendations to:

- develop an appropriate review and consultation process in relation to performance test changes;
- improve the proposed benchmark indices to avoid inappropriate test outcomes;
- improve communications with members of failing products; and
- better meet the overall intent of the performance test.

We look forward to ongoing engagement with Treasury and the Government as the proposals are finalised.

About Aware Super

Aware Super has been the fund for people who value the community since 1992. We're one of Australia's largest funds and we're continuing to grow.

We merged with VicSuper and WA Super in 2020 and managed almost $146 billion in retirement savings for more than 1.09 million members as at 30 June 2022, including more than $30 billion in retirement assets. Our members—including teachers, nurses, public servants and emergency services officers—work in roles that support our community, and they expect us to do the same by investing in ways that do well for them, and good for all.

Recommendations

1. Improve consultation process for future reviews of benchmark indices, including:
   a. providing clear, published principles to guide the selection of indices and justifying proposed changes against these principles;
   b. providing sufficient time to review and assess the impact of proposed changes;
   c. Ensure that all proposed indices are available for review as part of future consultations.

2. Consider options to reduce the cost burden of monitoring benchmark indices, and provide trial access to new indices for the purpose of appropriate consultation.

3. Extend the lookback period for the performance test to 10 years.

4. Retain current Bloomberg AusBond Composite Bond 0+ Index for Australian Fixed Income.

5. Apply the Bloomberg Global Aggregate Corporate Index (hedged AUD) for International Credit, and consult further on any proposal to allow for a slightly more granular treatment of Credit.

6. Consult on a more appropriate International Property index.

7. Replace the proposed benchmarks for Alternatives, Defensive Alternatives and Growth Alternatives with 'cash plus' benchmarks.

8. Make any further changes to benchmark indices prospective, to ensure prior performance is not re-assessed to a differing standard.

9. Ensure that expansion/adjustment of the benchmark indices does not unfairly penalise legitimate investment strategies

10. Consider where additional granularity in data collected by APRA could support better performance test outcomes.

11. Allow grouping of Australian and International asset classes to prevent single-sector products being inappropriately captured as TDPs

12. Include property in the list of asset classes that can be grouped under Regulation 9AB.2(4)

13. Consider creating more nuanced consequence pathways to align with further expansion of the performance test.

14. Undertake member testing to refine the letter to ensure that it is understood and prompts the intended behaviour.

Feedback on draft regulations

1. Proposed changes to performance test

A more considered consultation process is required

Aware Super welcomes the recognition that adjustments to the original benchmarks underpinning the performance test are required.

However, consultation on the proposed changes has been rushed and there has not been sufficient time to fully understand the impact of the proposals, for individual funds or as an industry.

In relation to consultation on the benchmark indices, we note that:

- the four-week consultation period is insufficient to fully work through and understand the proposed changes; and
- not all proposed indices are currently available, and as such we have not been able to review them as part of this consultation.

Given the importance of the benchmark indices to funds' investment decisions, a standard review process should be implemented that allows for appropriate consultation and consideration of material changes to the performance test.

There should be clear principles in place to guide the selection of indices (for example, they should be relevant, available, and widely used by industry), and any proposed changes should be accompanied by an explanation of why the index has been suggested, with reference to these principles.

There is also a material cost associated with accessing and monitoring the benchmarks used in the test, which should be considered as part of any proposal to change benchmarks. At a minimum, index providers should extend trial access to indices that are under consideration for inclusion, so funds can provide meaningful feedback. More broadly, the ongoing cost of these indices, which are effectively compulsory for funds to subscribe to, should be considered and industry-level arrangements reached to reduce the cost burden where possible.

Recommendation

1. Improve consultation process for future reviews of benchmark indices, including:
   a. providing clear, published principles to guide the selection of indices and justifying proposed changes against these principles;
   b. providing sufficient time to review and assess the impact of proposed changes;
   c. ensure that all proposed indices are available for review as part of future consultations.
2. Consider options to reduce the cost burden of monitoring benchmark indices, and provide trial access to new indices for the purpose of appropriate consultation.

Extending the lookback period

Aware Super supports extending the lookback period for the performance test to 10 years.

This strikes the appropriate balance between providing a sufficient period to assess investment performance, without taking an overly long-term view that may poorly reflect current outcomes and punish products that have improved performance.

The lookback period should be aligned across the performance test, APRA heatmap assessments and the ATO comparison tool.

Recommendation
3. Extend the lookback period for the performance test to 10 years.

Proposed benchmark changes

While some of the proposed changes to benchmarks are likely to improve the accuracy of the performance test, some of the proposals seem unlikely to achieve their goal.

We recommend further consultation to resolve issues with several of the proposed changes.

For example:

- **Australian Fixed Income**
    - The proposed change from the Composite Index to Master Index has no clear rationale.
    - The Master Index is not a commonly used measure of performance, and requiring funds to track this more complex benchmark would increase transaction costs for no apparent benefit.
    - The current Composite Index should be retained.
- **Credit indices**
    - There is inconsistency between the use of an investment grade index for Australian credit and a High Yield (sub investment grade) index for international credit.
    - The Bloomberg Global Aggregate Corporate Index (hedged AUD) would be a more appropriate index.
    - Over the longer term, we would suggest that APRA's SRS 550 asset class classifications could be updated to provide a more granular solution to cover the expanse of Credit, which should ideally consider both investment grade and sub investment grade indices across fixed and floating rate structures to ensure that it (a) more appropriately captures well-established industry practice, and (b) avoids unintended consequences.
    - The fee assumption of 0.10% is significantly too low for a High Yield index. Given the high cost of managing a High Yield portfolio, 0.40% would be a more appropriate fee assumption.
- **International Unlisted Property**
    - The proposed MSCI index appears to include Australian funds, which should be excluded to avoid double-counting of returns.

- The index is unfrozen, which creates risk of survivorship bias and retrospective changes – in general, frozen indices should be the preferred option.
- It is not clear why the index excludes Pan-Europe and Pan-Asian funds, and the gearing level for participation in the index is significantly higher than is typical of Australian superannuation funds.
- We do not currently have access to the proposed index, so it is not possible to make detailed comments on its suitability.
- A more representative index should be developed, and an interim solution determined through further consultation.

- **Alternative assets**
  - The proposed methodology does not resolve the issues with the current approach to benchmarking alternative assets. The role of Alternatives in portfolios is usually to provide a source of returns uncorrelated to mainstream asset classes like equities and bonds. A benchmark constructed of these mainstream asset classes is therefore inappropriate as it will have significant tracking error to the strategies employed in this asset class.
  - A 'cash plus' benchmark would be more appropriate for alternative assets, with Defensive and Growth Alternatives having outperformance hurdles reflecting the risk employed. Consultation with industry around setting these levels would be helpful and we would be happy to provide our internal benchmarks for these asset classes.

Additional detailed comments on the proposed indices are included in Section 3 below.

Recommendations

4. Retain current Bloomberg AusBond Composite Bond 0+ Index for Australian Fixed Income.
5. Apply the Bloomberg Global Aggregate Corporate Index (hedged AUD) for International Credit, and consult further on any proposal to allow for a slightly more granular treatment of Credit.
6. Consult on a more appropriate International Unlisted Property index.
7. Replace the proposed benchmarks for Alternatives, Defensive Alternatives and Growth Alternatives with 'cash plus' benchmarks.

Changes to benchmarks should be prospective

The benchmarks underpinning the performance test will need to be updated from time to time. However, retrospectively applying a new benchmark over the testing period will retrospectively shift the goalposts for performance measurement.

This is unfair and may create confusion if it impacts whether funds pass or fail the test, and should be avoided.

We understand the rationale for applying the current changes retrospectively to align the choice and MySuper tests. However, going forward, benchmark changes should be appropriately managed to ensure they do not penalise funds who have managed according to the previous benchmark.

While the introduction of the test necessitated a retrospective assessment, this is not the case for future years.

This includes:

- applying new or changed indices prospectively – ie, managing all previous performance years based on the indices in force in the relevant year;
- providing appropriate time to review and consult on proposed changes to benchmarks (as above); and
- providing appropriate time to transition to new benchmarks where required.

Recommendation
8. Make any further changes to benchmark indices prospective, to ensure prior performance is not re-assessed to a differing standard.

Balancing granularity and complexity

While adding additional benchmarks can add granularity and accuracy to the performance test (if implemented appropriately), there are trade-offs to this approach in terms of adding complexity to the test. It is also not possible to have benchmarks in place that can reflect all legitimate investment approaches.

This complexity will only increase as the performance test is extended to choice accumulation products, particularly for products that are less likely to directly track the regulated indices such as those with Socially Responsible Investment (SRI) strategies.

If the test is further expanded to single-sector products, this issue will be further magnified as strategies that do not track the particular index used in the performance test will be penalised.

As we have noted in our previous submission, this issue can be resolved by providing a more nuanced consequence pathway for products that fail the test (see Section 2 below) rather than a bright line pass/fail scenario.

It is also worth considering how APRA's SRS 550 asset class classifications could be revised to provide more granular data where it would clearly improve the accuracy of performance test outcomes. For example, in the Credit asset class there can be significant divergence in performance depending on whether the strategy invests in fixed or floating rate assets, investment grade or below investment grade as well as regional differences.

Recommendation
9. Ensure that expansion/adjustment of the benchmark indices does not unfairly penalise legitimate investment strategies 10. Consider where additional granularity in data collected by APRA could support better performance test outcomes.

Grouping asset classes

Item 12 proposes treating certain asset classes as one asset class for the purpose of determining whether a product is to be treated as a TDP.

This is a sensible approach to balance granularity in the benchmark indices with the intent of the TDP definition.

To effectively achieve this outcome, an additional grouping should be added to ensure that single sector options which include both Australian and international assets are not classified as multi-sector products for the purpose of the test.

Property should also be added to the list of asset classes that can be aggregated for this purpose.

Proposed drafting is included at Section 3 below.

Recommendation
11. Allow grouping of Australian and International asset classes to prevent single-sector products being inappropriately captured as TDPs 12. Include property in the list of asset classes that can be grouped under Regulation 9AB.2(4)

2. Achieving the objective of the Performance Test

Consequences of failure

As highlighted in Aware Super's submission to the review of the Your Future, Your Super package, there is a material risk for even good funds that they will fail the test eventually through random chance, simply as a result of taking active risk.

This risk becomes magnified when expanding the coverage of the test, due to the potential for legitimate investment strategies of less diversified options to be mismatched against the chosen indices.

In this context, it would be appropriate to move away from a one-size-fits-all set of consequences for failure, and create more tailored pathways based on the circumstances of a product's failure.

This would minimise unintended behavioural responses from funds at risk of failing the test for reasons other than systematic underperformance.

While this should not create a situation where failures of the test are not acknowledged or addressed, it would reduce concern about imperfect benchmarks that do not align well with legitimate investment approaches.

Recommendation
13. Consider creating more nuanced consequence pathways to align with further expansion of the performance test.

Underperformance letter

While we were pleased to see some changes to the legislated letter for underperforming funds, further work is required to make the letter appropriately helpful for members considering how to respond to their products failing the test. Our experience in delivering member communications has shown to us the importance of member testing in formulating these messages to ensure that they are well understood, prompt the intended behaviour in response, and appropriately inform members of all key considerations when changing products. We would be happy to engage further on the process of refining the letter.

Recommendation
14. Undertake member testing to refine the letter to ensure that it is understood and prompts the intended behaviour.

3. Detailed comments on draft regulations

Reference	Issue	Proposed Solution
9AB.2(4A)	The proposed subregulation 9AB.2(4A) allows grouping of asset classes for the purpose of determining a TDP. Additional groupings are required to meet the intent of this section.	Replace the proposed subregulation 9AB.2(4A) with the following: *(4A) Despite sub regulation (4), for the purposes of subparagraph (2)(b)(i), treat the covered asset classes for a quarter listed in each of the following paragraphs as each being one covered asset class for the quarter:* *(a) the covered asset classes identified in items 1, 2, 3, 4, 5, 6 and 7 of the table in regulation 9AB.17;* *(b) the covered asset classes identified in items 8, 9, 12 and 13 of that table;* *(bc) the covered asset classes identified in items 16, 17, 18, 20 and 21 of that table;* *(cd) the covered asset classes identified in items 22 and 23 of that table;* *(de) the covered asset classes identified in items 24, 25 and 26 of that table.*
9AB.5A(4)-(7)	The benchmarks for Alternative assets remain inappropriate, despite proposed amendments.	Introduce 'cash plus' benchmarks for alternative assets.
9AB.17(7) **Item 13**	The proposed *MSCI Global (Excl. Pan-Europe and Pan-Asia Funds) Quarterly Property Fund Index (Unfrozen) (Net Total Return; AUD fixed)* index raises a number of concerns: • The index appears to include Australian funds. This creates double-counting of domestic property returns and issues with consistency in APRA reporting;	Consult with industry on development of a more appropriate unlisted property benchmark and interim arrangements.

	• The exclusion of Pan-Europe and Pan-Asian funds has no clear rationale; • The 60% gearing limit for participating funds is not reflective of Australian superannuation funds; • The index is unfrozen.	
9AB.17(7) **Item 16**	There is no clear rationale for changing the current Bloomberg AusBond Composite Bond 0+ Index. The proposal to use the Bloomberg AusBond Master 0+ Yr Index creates several issues: • The existing Composite index is the most commonly used index and more suitable for the performance test. - The Master index is not an index generally used by superannuation funds to benchmark portfolios. - The Master index was primarily designed as an measure of issuance, rather than to measure market performance. - The Master Index is a more complex benchmark, and tracking it will increase transaction costs (which are passed through to members). - Tracking the Master Index changes the risk-return profile of the index, which is generally used to monitor the performance of stable and predictable defensive assets. • The Master Index includes allocations to assets which are not appropriate, including: - Inflation Linked securities, which are rarely held by super funds (and super funds entering this market to reduce YFYS tracking error would cause significant distortions in this market). - Corporate floating rate notes, which are not generally grouped into the same asset class as they don't have any material interest rate duration, are a pure credit exposure, and are more illiquid.	Retain Bloomberg AusBond Composite index for Australian fixed income.

9AB.17(7) **Item 21**	The use of a High Yield index for international credit raises several concerns: • This is unnecessarily inconsistent with the corporate Investment Grade index used for Australian credit. • While we understand Treasury's approach is intended to provide flexibility, an investment grade index would be more representative • Use of a fixed rate, rather than a floating rate index or a combination, for sub investment grade credit does not reflect the range of sub investment grade exposures.	Replace the proposed index with Bloomberg Global Aggregate Corporate Index (hedged AUD), which will result in fewer unintended outcomes. Introduce additional granularity into APRA 550 asset class classifications to allow differentiation between different forms of credit.
9AB.17(7) **Item 21**	This only applies if a high yield index is chosen as the expression of international credit: the fee assumption of 0.10% for a high yield index is unrealistic, due to the cost of building and managing these portfolios – 0.40% would be a more realistic assumption but more consultation would be required to validate this.	Consult further with specialist managers before setting fee assumptions for any High Yield Credit index.

s 22 [redacted]

From: s 22 [redacted]
Sent: Monday, 18 December 2023 4:11 PM
To: s 22 [redacted]
Subject: FW: Catch up in Canberra this Thursday? [SEC=OFFICIAL]

Follow Up Flag: Follow up
Flag Status: Flagged

OFFICIAL

From: s 47F [redacted]@aware.com.au>
Sent: Tuesday, 14 March 2023 9:43 AM
To: Spear, Luke <Luke.Spear@treasury.gov.au>
Cc: s 22 [redacted]@TREASURY.GOV.AU>; s 22 [redacted]@TREASURY.GOV.AU>; s 22 [redacted]@TREASURY.GOV.AU>
Subject: RE: Catch up in Canberra this Thursday? [SEC=OFFICIAL]

Hi Luke,

1.30 would be perfect, thanks for making the time!

Cheers

s 47F [redacted]

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From: Spear, Luke <Luke.Spear@treasury.gov.au>
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To: s 47F [redacted]@aware.com.au>
Cc: s 22 [redacted]@TREASURY.GOV.AU>; s 22 [redacted]@TREASURY.GOV.AU>; s 22 [redacted]@TREASURY.GOV.AU>
Subject: RE: Catch up in Canberra this Thursday? [SEC=OFFICIAL]

OFFICIAL

Hi s 47F

That sounds lovely – we have a gap between 1.30-3pm on Thursday if a slot around then suited?

luke

Luke Spear — **Assistant Secretary**
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From: s 47F @aware.com.au>
Sent: Monday, 13 March 2023 5:29 PM
To: Spear, Luke <Luke.Spear@treasury.gov.au>
Cc: s 22 @TREASURY.GOV.AU>; s 22 @TREASURY.GOV.AU>
Subject: Catch up in Canberra this Thursday?

Hi Luke,

Hope you're well.

I'm in town this Thursday, s 22

I thought it would be worth seeing if you and your team have time to catch up in person as well while I'm in the building. Would be great to chat Objective of Super, YFYS, as well as anything else on your team's agenda that we might be able to provide support on from either a fund or investor perspective.

If Thursday doesn't work, let's arrange a call in the next couple of weeks, as it feels like we're due for a check-in anyway with everything hitting the agenda!

Cheers

s 47F
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