Super Consumers Australia

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Superannuation Performance Test Treatment of Faith-based Products

All Australians deserve to be in a high-performing superannuation product. Super funds should be investing money in a way that adds value to a person's retirement outcomes. Following a faith based investment strategy doesn't change this basic principle. Proper scrutiny should be applied to these types of funds to ensure they are adding value while keeping to their stated faith based investment philosophy. Allowing a fund to help design its own test creates a significant risk of gaming, which could mask systemic issues with a fund, such as its lack of expertise, scale and general sustainability.

A system wide and publicly disclosed 'bright line' performance test helps ensure that a fund is focused on delivering returns which improve people's retirement outcomes. We welcome the proposal that faith-based products will continue to be subject to the original performance test. But without any repercussions for failure, there is a significant risk that people in faith-based products will miss out on the demonstrable benefits that have flowed to other people in underperforming funds.

Not all members of a fund will share the same faith as the fund. People typically find themselves in a fund because it is the default fund of their employer. In this case an employer may have a different faith to many of its employees. This is particularly so in a pluralist society like Australia, where faith based organisations hire people outside of the organisation's faith. Given the high incidence of people taking no active decision to join a particular fund, people are often defaulted into a fund of their employers choosing. According to Christian super, half of its 30,000 members were defaulted into the fund via their employers.[1] This is a cohort that may have no particular affinity with the investment philosophy of the fund. As the proposal stands, this cohort would not be informed of the fund's failure against the performance test and therefore may continue in a fund that delivers poor returns.

The Federal Government has announced a review into operation of the Your Future, Your Super laws after the second round of MySuper performance tests have taken place in August this year. Having decided to review the operation of the performance test the Government has paused the test's extension beyond MySuper products for 12 months. This provides an opportunity to take the time to consider and consult more comprehensively on any changes proposed to faith-based funds. Our understanding is that there is an extremely limited

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[1] https://www.investmentmagazine.com.au/2022/05/fund-members-stand-by-christian-super/

pool of MySuper products that may be eligible to be determined a faith-based product. This means there is less urgency to implement a solution for any faith-based product before this broader review is conducted.

Assessing this proposal alongside the review into the Your Future, Your Super legislation will allow sufficient time to consider the implications of this change, including:

- The merits and efficacy of a disclosure regime in helping people to make an informed decision about whether to stay in an underperforming faith-based fund,
- The implications on the broader system of moving the purpose of superannuation towards faith-based outcomes for some funds,
- The adequacy of the regulator's powers to ensure faith based funds are delivering appropriate returns to members (e.g. the nature of the alternative test and definition of a faith based fund).

The need for public scrutiny

In its first year of operation the annual performance test has been responsible for an effective clean up of a large portion of the tail of underperforming MySuper products. This is due to the serious consequences imposed on products when they fail. Under proposed legislation for faith-based products the same consequences do not apply. A faith-based product only faces consequences if it fails a supplementary test. The legislation proposes that this test may be based on an alternative index or indices which the fund supplies to APRA. APRA must decide if this alternative index or indices reflects the investment philosophy of the faith-based fund. However, APRA is given little guidance on how to perform this function. As we understand it, there will be significant difficulty in finding an appropriate independently created benchmark for a faith based fund. By giving discretion to a fund to find or develop its own benchmark, there is a significant risk of it selecting a favourable benchmark. For example, a fund could develop and present an index which very closely reflected its actual investments. In effect allowing it to almost compare itself to itself, or a test which it should not realistically fail.

This approach is likely to lead to insufficient pressure being applied to a fund which is not delivering value to its members. In doing this it would remove pressure on the fund to make improvements to its expertise, scale and general sustainability.

This approach may see a product underperform the universal benchmark for years without scrutiny. The Productivity Commission found that an average person invested across a lifetime in an underperforming MySuper product could be $502,000 worse off by retirement, compared to being in a top performer.[2] It is incumbent on policy makers to ensure adequate scrutiny is

[2] Productivity Commission Inquiry report - Superannuation: Assessing Efficiency and Competitiveness, p13

applied to all superannuation products to avoid this from happening again.

There is evidence that a faith-based product need not fail the performance test as it stands. For example, Australian Ethical's MySuper product pursues a strategy which excludes investments in alcohol, tobacco, weapons and gambling. These are areas commonly excluded by faith-based products, yet Australian Ethical still managed to pass the performance test by 132 basis points.[3] While ESG funds may have more scope in their investment philosophy than stricter faith-based funds, there are common learnings and strategies that can be applied to avoid undeperforance.

For the reasons outlined above we do not support the proposal as it is currently formulated and encourage the Federal Government to fold the proposals into the broader post implementation review of YF,YS. This will allow for proper consideration of the issues raised with the proposal. Failing this we recommend the legislation be amended to require informed consent of members in these failed funds, to ensure they are aware of the implications of failure against the general test, rather than just the supplementary test. We acknowledge disclosure is a poor consumer protection, especially when it comes to superannuation. Early reports from the performance test conducted last year showed only a small minority of people left their product after being informed it was underperforming. However, we are concerned that without any repercussions there will be no substantial incentive for faith-based funds to improve. As a result people will be left to languish in underperforming funds and are likely to experience materially poorer retirements.

Recommendation

That appropriate treatment of faith-based products should be considered as part of the post implementation review of the Your Future, Your Super legislation.

[3] https://www.australianethical.com.au/why-ae/ethics/ethical-criteria/ and APRA Heatmap Mysuper Products December 16