

EXPOSURE DRAFT

EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer and Minister for Financial Services

Superannuation Industry (Supervision) Act 1993

Superannuation Industry (Supervision) Amendment (Annual performance assessments—Faith-based products) Regulations 2022

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) governs the prudent management of superannuation funds and the supervision by the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Commissioner of Taxation.

Section 353 of the SIS Act provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The purpose of the *Superannuation Industry (Supervision) Amendment (Annual performance assessments—Faith-based products) Regulations 2022* (the Regulations) is to amend the *Superannuation Industry (Supervision) Regulations 1994* to support amendments made to the SIS Act which give effect to the Government's election commitment to account for a product's faith-based principles when applying the annual performance test.

Schedule 5 to the *Treasury Laws Amendment (2022 Measures No. 3) Act 2022* amends the SIS Act to provide for a supplementary annual performance test for faith-based products. APRA may determine that a product is a faith-based product if a trustee for the product makes a valid application. An application is valid if it meets the requirements set out in subsection 60L(2) of the SIS Act. A faith-based product passes the annual performance test if it passes the original or the supplementary performance test. A supplementary performance test for faith-based products allows a product's faith-based investment strategy to be taken into account when assessing the performance of the product against benchmarks.

The Regulations include amendments that support the implementation of a supplementary performance test by specifying:

- when APRA must conduct the supplementary performance test;
- how APRA may determine and apply alternative indices for the purposes of conducting the supplementary performance test; and
- additional information that must be included in an application for faith-based status.

The SIS Act specifies no conditions that need to be met before the power to make the proposed Regulations may be exercised.

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The proposed Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The proposed Regulations commence on the day after registration.

The Regulations have been assessed as having no more than a minor regulatory impact (OBPR Reference Number OBPR22-02502). Accordingly, no Regulatory Impact Statement has been prepared.

The compliance costs of this measure are expected to be low.

Details of the proposed Regulations are set out in Attachment A.

Details of the *Superannuation Industry (Supervision) Amendment (Annual performance assessments—Faith-based products) Regulations 2022*

Section 1 – Name of the Regulations

This section provides that the name of the Regulations is the *Superannuation Industry (Supervision) Amendment (annual performance assessments—Faith-based products) Regulations 2022* (the Regulations).

Section 2 – Commencement

Schedule 1 to the Regulations commence on the day after the instrument is registered on the Federal Register of Legislation.

Section 3 – Authority

The Regulations are made under the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Section 4 – Schedule

This section provides that each instrument that is specified in the Schedule to the proposed Regulations will be amended or repealed as set out in the applicable items in the Schedules, and any other item in the Schedule to the proposed Regulations has effect according to its terms.

Schedule 1 – Amendments to the *Superannuation Industry (Supervision) Regulations 1994* (the Principal Regulations)

Legislative references in this Schedule are made to the Principal Regulations unless otherwise specified.

Items 1 and 2 – When APRA must conduct the supplementary performance test

Under subsections 60P(1) to (3) of the SIS Act, if a faith-based product fails the original performance test in subsections 60C(2) and 60D(1), APRA must perform a supplementary performance test. Subsection 60P(5) of the SIS Act provides that the regulations may specify the time period for APRA to make this assessment, determining if the product meets the requirements of the assessment and notify the trustee(s) within a period given by the regulations.

Item 2 inserts new regulation 9AB.8(2) to require APRA to make the supplementary determination and give the notification to the trustee(s) within the same period as required for the determination and notification processes of the original determination. Under the Principal Regulations, APRA must conduct the test and notify the trustee(s) by the 1 September after the end of the financial year of the performance test. The amendment ensures that the process of determinations and notifications for faith-based products under the supplementary performance test will be completed within the same period as for products subject to the original performance test.

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Item 1 makes a consequential editorial amendment to update the numbering for regulation 9AB.8.

Item 3 – Alternative assumed indices for the supplementary performance test

Section 60Q of the SIS Act allows regulations to specify requirements for the supplementary performance test.

Item 3 inserts new regulation 9AB.18A to provide that, for the purposes of conducting a supplementary performance test for a faith-based product, APRA may make a determination specifying alternative assumed indices for the covered asset classes in the table in regulation 9AB.17 of the Principal Regulations. The amendment ensures that the product's investment in accordance with faith-based principles can be taken into account when calculating a product's 'benchmark return'.

The use of alternative indices will affect the 'index' variable in the performance test ('index' is a variable in the formula for a product's 'benchmark return', as calculated in regulations 9AB.14 and 9AB.15). This means that the 'actual return', 'actual RAFE' and 'benchmark RAFE', as calculated in regulations 9AB.11, 9AB.12 and 9AB.16 will remain unchanged. The 'benchmark return' may differ between the original and supplementary performance tests due to the use of different indices. This is the only difference between the original performance test and the supplementary performance test.

Paragraph 60L(2)(c) of the SIS Act requires trustees to provide APRA with an alternative index or indices that APRA could use for the supplementary performance test when applying for faith-based status.

New subregulation 9AB.18A(3) requires APRA to consider the suitability of any of the indices provided in the application for faith-based status when determining alternative assumed indices for the product. Trustees are expected to provide alternative indices that reflect the product's faith-based investment strategy. In deciding on an alternative index or indices, APRA will consider whether the provided alternative index or indices reflects the product's faith-based investment strategy. It is not expected that APRA will investigate all available indices or propose alternative indices in making a determination.

New subregulation 9AB.18A(4) allows APRA to substitute alternative indices to replace the assumed indices mentioned in the table in regulation 9AB.17 for the specified quarters when calculating the supplementary test results.

The determination made by APRA must be in writing and specify the relevant product, the relevant financial year, the alternative index and the assumed index that it replaces.

APRA may specify different assumed indices for different quarters during the lookback period. This ensures the supplementary performance test can reflect any changes to the product's faith-based status or faith-based investment strategy over the lookback period.

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Item 4 – Additional information requirements for faith-based status application

Paragraph 60L(2)(d) of the SIS Act states that regulations may specify additional information which must be contained in an application for faith-based status. Item 4 inserts new regulation 9AB.20A to set out this additional information. The amendment ensures that APRA is provided with the necessary information to make a faith-based status determination.

New regulation 9AB.20A(2)(a) specifies that the application must contain information that demonstrates the product's investment strategy accords with faith-based principles. This may be the product's investment strategy or investment policy, board or investment committee papers of the entity, or other information. This requirement ensures that the trustee provides evidence to support the declaration that the product has a faith-based investment strategy, as required by subparagraph 60L(2)(b)(i) of the SIS Act. Subparagraph 9AB.20A(2)(a)(iii) does not require trustees to provide an entire board or investment committee papers, rather trustees may provide extracts. The requirement is met if the extracts demonstrate that the investment strategy for the product accords with faith-based principles. This ensures that APRA is given the information from within a larger document that is most relevant for the purposes of the assessment of whether the product is a faith-based product.

New regulation 9AB.20A(2)(b) specifies that the application must contain information to support the trustee's declaration under subparagraph 60L(2)(b)(ii) regarding the trustee's disclosure of the product's faith-based investment strategy to members. The trustee is required to provide at least one of:

- the product's most recent Product Disclosure Statement, including any information incorporated by reference;
- the product's most recent target market determination;
- the entity's most recent annual report; or
- information from the entity's website.

The information or document provided must demonstrate that the investment strategy for the product accords with faith-based principles. The amendments do not require trustees to provide an entire Product Disclosure Statement or annual report, rather trustees may provide extracts. The requirement is met if the extracts demonstrate that the investment strategy for the product accords with faith-based principles. This ensures that APRA is given the information from within a larger document that is most relevant for the purposes of the assessment of whether the product is a faith-based product.

New regulation 9AB.20A(2)(c) requires that the application must contain information about the period during which the product has had a faith-based investment strategy and whether that investment strategy has changed over time. Together with the amendment inserted by Item 3, this ensures APRA will have the necessary information to determine appropriate assumed indices for each quarter in the lookback period.