Australian Government
The Treasury

Your Future, Your Super Review

Consultation paper

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Contents

Consultation process

Request for feedback and comments

The purpose of this paper is to seek feedback on any unintended consequences and implementation issues from the Your Future, Your Super measures.

Submissions in response to this paper should be provided electronically by close of business on 14 October 2022. For accessibility reasons, please submit responses by email in Word or PDF format.

All information (including name and address details) contained in submissions may be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: 14 October 2022

Email	YFYS@treasury.gov.au
Enquiries	Enquiries can be initially directed to the Director of the Superannuation, Efficiency and Performance Unit.

Your Future, Your Super review

Background

The *Treasury Laws Amendment (Your Future, Your Super) Act 2021* received royal assent on 22 June 2021 with supporting regulations made in August 2021. The Your Future, Your Super (YFYS) measures, which are now law, are aimed at increasing member engagement, reducing fees, increasing performance, and holding trustees to account for the decisions they make.

The YFYS measures involve four key elements to improve the superannuation system:

- **Performance test** — Products are subject to an annual performance test with clear consequences. The test applied to MySuper products from 1 July 2021. The test was designed to protect members from underperformance by holding trustees accountable for the investment performance they deliver to members and encouraging trustees to reduce fees.
- **YourSuper comparison tool** – MySuper products are displayed on a comparison tool which launched on 1 July 2021 and aims to assist members to choose a well-performing MySuper product. The objective of the tool is to empower members to make informed decisions about who manages their retirement savings.
- **Stapling** – If a new employee does not choose a fund, then employers must check whether they have an existing 'stapled' superannuation fund before opening a new default superannuation account. Stapling started on 1 November 2021 and seeks to prevent the creation of unintended multiple accounts by ensuring superannuation follows individuals as they change jobs.
- **Best financial interests duty (BFID) –** Trustees need to assess whether their spending is in the best financial interest of their members and now must provide evidence to demonstrate this fact in the event of civil proceedings. Commencing from 1 July 2021, the best financial interests duty seeks to increase transparency and accountability for the way trustees manage their business operations to the benefit of members.

Purpose

The purpose of this review is to assess any unintended consequences and implementation issues of the YFYS legislation. The review will cover all four elements of the YFYS measures. It will not address other issues unless they are directly related to the implementation or associated outcomes of the YFYS legislation. The focus of this review is on ensuring that Australian superannuation funds perform better, delivering dignity in retirement, and avoiding perverse outcomes for members.

Issues for discussion

Performance test

The YFYS performance test (the test) for MySuper products came into effect on 1 July 2021. It was introduced to protect Australians' retirement savings by holding trustees to account for the investment performance they deliver and the fees they charge to members.

The PC review recommended that, in light of muted demand-side pressure in the superannuation market, measures are needed to remove persistently underperforming products in order to improve outcomes for members of those products. To achieve this, the review recommended a clear and objective test for the 'right to remain' in the super system.

A clear and objective performance test would improve performance and accountability of funds by using clear and objective benchmarks and consequences of not meeting those benchmarks. This would ensure that trustees are assessed on an objective basis, beyond how they choose their own methods of performance comparison and provides greater clarity and certainty about when regulator action can be expected.

The Australian Prudential Regulation Authority (APRA) conducts the test each year. The test assesses a product's net investment returns against an objective benchmark portfolio tailored to its investment strategy and assesses its administration fees against its peers. Trustees of products that fail the test must notify affected members. Products that fail the test two years in a row are closed to new members until they pass a future test.

The test was applied to MySuper products from 1 July 2021. MySuper products are intended to be simple, cost-effective and balanced investment options eligible to receive default contributions. The test is scheduled to be extended to a subset of Choice (non-MySuper) products — defined as trustee-directed products (TDPs) — from 1 July 2023.

The test is intended to improve outcomes for members by:

- ensuring that members do not join persistently underperforming products
- providing members with information to choose better performing products
- encouraging underperforming products to improve their performance, including through potential mergers with higher-performing funds.

How it is going

MySuper products have been tested twice since the test was introduced.

On 31 August 2021, the first test was run on 80 MySuper products covering about 14 million member accounts worth around $900 billion.[1] There were 13 MySuper products that failed the test, covering about 1 million member accounts worth around $56 billion. Trustees of these products were required to notify their members by 28 September 2021 and disclose the test result on their website.

The first test had a significant impact on the 13 MySuper products that failed.

Some members left these underperforming products. As at 31 January 2022, about 100,000 member accounts in these underperforming products worth around $4 billion had been closed — a 10 per cent

[1] Australian Prudential Regulation Authority (August 2021), Your Future, Your Super Performance Test [website], accessed 24 August 2022.

decrease in accounts from 30 August 2021. Member outflows were highest during the period in which notification letters were being received by members.

Further, ten of these products have merged or are in the process of being merged into better performing funds, representing about 70 per cent of member accounts and assets in underperforming products. The three remaining products are subject to increased supervision by APRA, and two of these products have temporarily or permanently decreased fees for members.

On 31 August 2022, the second test was run. There were 5 MySuper products that failed the test, covering about 600,000 member accounts worth around $28 billion. Trustees of these products are required to notify their members by 28 September 2022 and disclose the result on their website.

There were 4 products that failed the test for two years in a row, covering about 560,000 accounts worth around $25 billion. These products are no longer able to accept new members from 31 August 2022. There was one product that passed the 2021 performance test but failed for the first time in 2022[2].

Issues for consultation

This review provides an opportunity to assess the extent to which there have been implementation issues or unintended consequences of the test for MySuper products, and whether there are likely to be issues as the test is extended to other products.

Treasury is interested in stakeholder views about solutions which can build on and improve the operation of the test in order to further improve outcomes for members.

Given the substantial benefits to members, it will be important that ideas to address issues maintain the integrity of the test and its objectives: to increase accountability and transparency of product performance through an objective benchmarking test with clear consequences.

For the purposes of this paper, Treasury is seeking stakeholder input on the test methodology, the consequences of failure and product coverage.

Test methodology

The test is based on the methodology adopted by the Productivity Commission (after consultation with industry) and further refined by APRA in its Heatmap analysis.[3]

The test methodology is detailed in the *Superannuation Industry (Supervision) Regulations 1994*. The methodology involves calculating a *performance measure* for each product tested:

$$Performance\ measure = (Actual\ return - Benchmark\ return) + (Benchmark\ RAFE - Actual\ RAFE)$$

There are two components to calculating the performance measure.

First, the net investment return of a product over the past eight years (*actual return*) is compared to a *benchmark return*. The benchmark return is a passive investment portfolio of indices tailored to the product's reported strategic asset allocation. As noted in the PC review, using a benchmark portfolio to assess investment performance aims to account for the many influences on investment markets which are beyond funds' control, while providing insights into the value added by funds.

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[2] Australian Prudential Regulation Authority (August 2021), APRA releases 2022 MySuper performance test results [website], accessed 24 August 2022.

[3] Australian Prudential Regulation Authority (December 2021), Superannuation Heatmaps [website], accessed 24 August 2022.

Second, the product's representative administration fees and expenses (*actual RAFE*) for the most recent financial year is compared to the median RAFE (*benchmark RAFE*). RAFE is calculated to represent a member who has an account balance of $50,000. The benchmark RAFE will be calculated separately for MySuper products and TDPs.

A product fails the test if the performance measure is lower than -0.005 (or -0.5%). The performance measure is used to identify persistent underperformers so that consequences can be applied that hold trustees to account for underperformance and increase transparency for members.

Treasury is interested in feedback from stakeholders about whether the test methodology is achieving its objectives, whether there have been any issues resulting from its implementation, and any unintended outcomes.

Consultation questions

1. Does the measurement of *actual return* using strategic asset allocation affect risk-taking behaviour by superannuation trustees?
2. Does the current set of indices used to calculate *benchmark returns* unintentionally distort investment decisions or reduce choice for members? If so, is there a way to adjust the benchmark indices while maintaining a clear and objective performance test?
3. Does the calculation of *actual RAFE* and *benchmark RAFE* discourage non-performance related product features that members may value (such as customer service or platform products)? If so, can this be addressed without diminishing the test's focus on performance?
4. What are the longer-term impacts of the performance test on market dynamics and composition? How will these factors impact on long-term member outcomes?

Consequences of failure

All products that fail the test face a clear set of consequences.

Trustees of products that fail the test have 28 days to notify affected product holders by letter and email (where available) using standard information prescribed in regulations. As part of this notification, members are prompted to consider switching to a different superannuation product and informed that the YourSuper comparison tool is available to help them to compare products. Trustees must also publish information about a test failure on the fund's website.

APRA must also publish a list of the underperforming products on its website each year.

Products that fail the test two years in a row are closed to new members until they pass a future test. This is intended to stem the flow of contributions into underperforming products, protecting members from poor outcomes. As part of APRA's supervision, trustees of these products will need to justify how they are meeting their obligations to existing members if they do not merge or improve their performance.

Consultation questions

5. Is there evidence to indicate that the notification and website publication requirements have been effective at encouraging members to consider, and switch to, alternative products? Are there ways this could be improved?
6. Have the consequences been effective at encouraging trustees to improve their performance or merge with better performing funds? Are there ways this could be improved?

7. Are the measures in place to resolve underperformance sufficient given the potential for members to be stapled to these products? How can the system best support members in underperforming products?

Product coverage

The test has applied to MySuper products over the past two years.

It is scheduled to be extended to TDPs from 1 July 2023. TDPs are multi-sector Choice accumulation products where the trustee or a connected entity controls the design or implementation of the investment strategy.

TDPs have been scheduled to be included in the test because these products are most comparable to MySuper products (in terms of product design), and APRA is now collecting data about them. Further, MySuper products and TDPs together are expected to cover the majority of accumulation assets regulated by APRA (excluding defined benefit interests).

Nevertheless, TDPs tend to be more varied and complex than MySuper products and reflect an active choice made by members. As such, Treasury is interested in stakeholder feedback about whether there are likely to be any technical implementation issues or unintended consequences from extending the existing test to TDPs and how these could be addressed while maintaining the integrity of a clear and objective test.

Other products could also be considered for inclusion in the test:

- Single sector products — products that invest in a single asset class (or two asset classes where one is 90 per cent or more).
- Externally directed products (EDPs) — products where the trustee or connected entity has no control or influence over the design and implementation of the investment strategy (unlike TDPs).
- Retirement products — products designed for members who have left the workforce and are drawing from their superannuation in the pension phase.

It will be important to consider whether the test methodology is applicable to these other products and whether they have broader policy goals beyond investment performance. For example, for some retirement products (such as annuities), the member does not bear the investment risk, meaning it is not necessarily possible to test investment performance. Further, the Retirement Income Covenant requires trustees to formulate a strategy to balance additional objectives for beneficiaries who are approaching or are in retirement, such as managing risks to the sustainability and stability of retirement income.

Consultation questions

8. Are there any significant issues to be expected when the test is extended to TDPs? If so, how could these issues be addressed?
9. What would be the impact of extending the current performance test to other Choice products (such as single sector or retirement products)? How could any issues be addressed?

YourSuper comparison tool

The YourSuper Comparison Tool (comparison tool)[4] was launched on 1 July 2021 as an interactive tool to help members make better decisions about who manages their retirement savings.

The PC review highlighted weak member engagement and demand-side pressure in the superannuation system and the need for a centralised online service that allows members to compare products and consolidate accounts.

The comparison tool should achieve two key objectives. First, to improve member engagement by providing members with simple, clear and trusted information to help them to compare and choose a well-performing MySuper product. Second, to encourage funds to compete by lowering fees and increasing returns for members.

How it works

The comparison tool was co-designed by the Australian Tax Office (ATO), APRA and the Australian Securities and Investment Commission (ASIC) and is hosted by the ATO. The information displayed is based on data that superannuation funds report to APRA.

The comparison tool displays three core metrics for all MySuper products:

- Fees – calculated as the total of all investment, administration and advice fees charged to an account based on a $50,000 balance.
- Net Returns – calculated as the eight-year annualised average rate of return received from the investments after all administration and investment fees, costs, taxes and advice fees[5].
- Investment performance – categorised as either 'Performing', 'Underperforming' or 'Not assessed' based on the results of the annual performance test. This metric is updated after 31 August each year to reflect the most recent performance test results.

MySuper products are sorted from lowest to highest fees by default. Although users are able to sort products by other characteristics. Under-performing products will always default to the bottom of the list.

Users can access additional metrics for up to four products at a time using a shortlist. This includes: three-, five- and seven-year net returns; whether the product has a lifecycle investment approach; and whether the fund is restricted to certain employers.

The comparison tool can be accessed through a non-authenticated version or an authenticated version. The authenticated version has added functionality of allowing members to compare their current superannuation accounts to those available on the comparison tool. Members can also view annual fees based on their current superannuation balance and will be prompted to consider consolidating accounts if they have more than one.

For members seeking further detail, the comparison tool provides a link to the products' MySuper Product Dashboard. These dashboards are made publicly available on fund websites and provide additional information on performance, risk and fees. However, these metrics are not always consistent with the metrics reported in the comparison tool.

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[4] Australian Taxation Office (March 2022), YourSuper comparison tool [website], accessed 24 August 2022.

[5] For the first year, this metric was based on seven-year returns due to constraints on available historical data.

How it is going

The comparison tool has demonstrated high levels of member usage receiving over 1.5 million views since it went live on 1 July 2021. During the period 1 July 2021 to 30 June 2022, around 430,000 members used the authenticated version of the comparison tool, which correlated with around 158,000 of these members changing their superannuation accounts in the same period[6].

Treasury is interested in stakeholder feedback about whether the tool is having its intended effect to empower members and encourage competition, and how best this can be measured. This includes feedback about whether the existing metrics used in the tool are sufficient or whether additional metrics may be useful to avoid unintended consequences. For example, anecdotal evidence suggests that without an appropriate risk metric, members may unintentionally be moving to products that are subject to more investment risk.

Consultation questions

10. Does the comparison tool adequately inform members and prompt a behavioural response? Is the tool effective at informing new employees of their options when entering the workforce, including those who do not have an existing superannuation account?

11. To what extent would altered or additional metrics, or improved functionality, make the tool more effective while ensuring it remains simple and clear? What more can be done to ensure that new employees are able to choose high-performing superannuation product that are appropriate for their needs?

12. As the test is applied to more superannuation products, should the comparison tool also be extended? Considering the volume and complexity of Choice products, how could the tool be extended in a way that is meaningful and digestible to members?

[6] Data relating to member activity is available only for the authenticated version of the tool. The non-authenticated version does not require member data and therefore these events are not tracked.

Stapling

Stapling commenced on 1 November 2021 and seeks to prevent the creation of unintended multiple superannuation accounts when disengaged members change jobs and open a new account by default. Unintended multiple accounts result in members being subject to multiple sets of account fees and potentially duplicate insurance arrangements which ultimately erode retirement savings. The impact of unintended multiple accounts was a key area of focus in the PC review.

How it works

Prior to stapling, when an individual changed jobs and did not choose a preferred superannuation fund, the employer could open a new superannuation account for the employee using the employer's 'default' fund.

Stapling adds an additional step for employers who must now check whether an employee has an existing ('stapled') super fund with the ATO before making super contributions. Employers may have to pay a choice shortfall penalty, which is additional super guarantee charge, if they contribute to a default fund without making a stapled super fund request. This is designed to ensure that where an employee does not choose a fund, their existing superannuation account follows them to their new job, rather than opening a new additional default account. Default accounts should only be created where a new employee does not provide a choice of fund and the ATO advises the employer that there is no stapled fund information on record for the employee, or the employee actively chooses the default fund of the employer.

This new step currently requires employers, or their authorised representative, to log in to ATO Online Services and input employee details to generate details of the new employee's stapled superannuation account. A wholesale solution is being developed by the ATO which will allow digital service providers to integrate stapling request functionality into their software and allow users to automatically request stapled fund information through their payroll system. This wholesale solution is due to roll out by the end of 2022.

How it is going

The ATO received nearly 290,000 stapled fund requests from the commencement of stapling on 1 November 2021 to 30 June 2022. Data limitations inhibit the ability to conclusively evaluate the efficacy of the stapling initiative, given the ATO does not receive data on how many new employees have elected a 'choice of fund' with their employer over the period. Understanding the extent to which 'choice of fund' elections and default account openings are occurring as well as the number of successful stapled fund requests is imperative to determining the effectiveness of stapling. Anecdotal evidence suggests that some employers have encouraged new employees to choose a fund (including the default fund) to avoid the stapling requirements.

Consultation Questions

14. To what extent are employers putting into practice processes to seek stapled fund details from the ATO? How has the implementation of stapling changed onboarding, software and payroll processes for new employees?
15. Are there any barriers in the current framework to achieve the intent of the stapling reform?
16. What is the actual, or likely, impact of stapling on insurance coverage?

Best financial interests duty

The BFID came into effect on 1 July 2021. The duty was intended to clarify that it is the financial interests of members that trustees must be guided by when making decisions. This is particularly important given the universal coverage of superannuation.

The PC review recommended that the Government should pursue a clearer articulation of what it means for a trustee to act in members' best interests under the *Superannuation Industry (Supervision) Act 1993*.

How it works

The introduction of the BFID involved three key components:

- Require each trustee of a registrable superannuation entity (RSE) or self-managed superannuation fund to perform the trustee's duties and exercise the trustee's powers in the best financial interests of the members.
- Require each director of the corporate trustee of an RSE to perform the director's duties and exercise the director's powers in the best financial interests of the members.
- Reverse the evidential burden of proof so that the onus is on the trustee of an RSE to point to evidence that their actions were consistent with the best financial interests duty in a civil penalty proceeding.

How it is going

APRA continues to seek information about how trustees have updated, or are updating, their policies and procedures to respond to the amended duty. Anecdotal evidence suggests the duty has driven some positive behaviours, with trustees putting in place a wide range of approaches to respond to the duty, especially in the context of recording compliance. Other experiences indicate trustees have a lack of clarity in how to record compliance.

Trustees with sound governance and oversight arrangements tend to already document the basis on which they make decisions, including in the best financial interests of their members. This might include a business case, including quantification of expected outcomes, cost–benefit analysis, statement of risks and mitigation strategy.

There is an important need to clarify whether the BFID measures and particularly the related regulatory changes are improving compliance practices in the superannuation industry. Given the universal coverages of superannuation, there is a clear public interest in placing a high level of scrutiny of trustees and ensuring that their actions are in the best financial interest of members.

Consultation questions

17. To what extent has the BFID required trustees to change their processes and procedures? Has this caused any unintended consequences or impacted member outcomes in any way?
18. Are there certain types of expenditure or activity that trustees are particularly concerned about being able to prove compliance with the BFID in respect of? Why is it difficult to demonstrate compliance? Should there be a materiality threshold?
19. Is the reverse onus of proof the most appropriate way to achieve the objective of improving member outcomes?