



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.