



# YFYS Review

## Technical Working Group Meeting 3 – Summary Note

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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.