YOUR FUTURE, YOUR SUPER REVIEW CONSULTATION RESPONSE

EXECUTIVE SUMMARY

This paper outlines some responses to the questions proposed in the Your Future, Your Super review and also proposes some recommendations specifically with respect to Best Financial Interest Duty policy guidance.

1. Performance test - In the use of the performance test benchmark, although we do not have specific evidence that the performance benchmark is distorting trustee investment decisions and the overall market investment pattern, similar benchmarks in overseas jurisdictions in equities and fixed income do distort markets, and we believe the same will be measurable in Australia over time.

2. Best Financial Interest Duty - There is also evidence to suggest that Best Financial Interest Duty is too narrow in its scope for trustees, and trustees should have stronger guidance to invest in longer-term, ESG-positive infrastructure and technology investments that will have a positive impact on higher growth in Australia over the long term, and *ceteris paribas,* higher standard of living outcomes for retirees in the longer term.

3. Accelerating investment in ESG-positive, long-term national building infrastructure and technology projects - Finally, we introduce a policy that should encourage members to be more engaged in their superannuation investments in long-term ESG-positive infrastructure and technology investments in Australia, whereby they can instruct their trustee to invest their superannuation contribution in specific government sanctioned projects and increase the scope of the trustee's Best Interest Duty for these specific investments.

PERFORMANCE TEST

1. *Does the measurement of actual return using strategic asset allocation affect risk taking behaviour by superannuation trustees?*
    a. No response as we are not a superannuation trustee, and do not have specific insights

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?*

    a. There are multiple sources of empirical study which suggest benchmarks like the current set of benchmark portfolio indices distorts investment decisions in equity and fixed income investments[1]
    b. Based on the methodology used in the benchmark, for example, as choices on portfolio construction for SAA and SRP portfolios use passive benchmarks, high liquidity, and in some cases 50% domestic and 50% international, the 'safest' option for a portfolio manager 'to do well' against the APRA benchmarks is to be heavier in assets similar to the benchmark portfolio (passive, highly liquid, 50/50 etc.). As the footnoted documents describe, this bias over time drives portfolio investments towards larger equities held in passive indices. Moreover, this will also move investment away from privately held companies and potentially better-performing, less-liquid investments. This is a distortion towards passive public market investments and away from active private investments. An example of this would put downward pressure on investment in venture capital and private assets in Australia which is arguably required to keep Australia globally competitive in the long run, in climate change sustainable energy technology as an example (today the majority of which is in private, not public markets).
    c. Infrastructure equity and direct infrastructure investment benchmarks are a reasonably new concept globally and we could not find any research or evidence of investment decision distortion.
    d. It is logical to suggest that measuring investment decision performance on either an infrastructure equity or direct infrastructure investment over a 5-year benchmark period, will distort investment decisions to more short-term projects. Returns on infrastructure should generally be considered on a 15+ year horizon, and a benchmark period shorter than this will tend to bias investments where a return can be seen in a far shorter timeframe, thus limiting investment in larger, more nation building, and longer projects that will drive long term and sustainable economic growth

[1] Equities distortion related to benchmarking (Asset Prices and Institutional Investors [Pavlova], American Economic Review Vol 103, No 5, August 2013), Fixed income distortion related to benchmarking (The Impact of Benchmarking in Fixed Income Markets [Ottonello] – September 26, 2019), Lack of infrastructure investment benchmarks globally and thus historical impacts of said benchmarks (Building benchmarks for infrastructure investors: a long but worthwhile journey [Tame, Blanc-Brude] – Getting Infrastructure Finance Right – World Bank 2018)

in Australia, and higher long-run returns for members. Noted that research papers and evidence of this could not be found related to global fund investment in infrastructure and its negative impacts, of any measurement benchmarks, although they should start to appear over the coming years.

e. Adjusting the benchmarks period based on asset classes would be one method to lessen the impact of the benchmark on investment decisions, especially for infrastructure and nation building investments
f. Member choice is restricted due to the benchmarks, as investments tend towards passive, large equity investments in Australia and internationally. However we do not believe that changing the benchmark will significantly improve choice for members
g. We believe that increasing choice for members is not exclusively a benchmark issue, and options to improve choice are discussed in other sections of this document

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?*
    a. While we do not have any specific evidence, increased competition on cost/fees in other industries does not have any clear linkage to competition on service levels. Call centre benchmarks could be argued as a reasonable proxy to RAFE, and they are widely shared and transparent across the industry. However, customer service levels and NPS is not correlated to reductions in cost levels, noting that individual companies are not directly compared against the benchmark publicly. As such there is an argument to publish the average RAFE without directly publishing the individual trustees RAFE, and instead only ask the Trustee to share this explicitly with their members.
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?*
    a. As highlighted in the benchmark impact research documents described above in equities and fixed income, investment decisions in fund inflows and outflows, tend towards increased investment in assets/stocks/instruments that are part of the passive index in which the trustee believes is closest to that in which the benchmark is formed.
    b. In its simplest form, due to the construction of the benchmark this will direct trustee investments away from illiquid, long maturity investments, which are often in privately held assets that deliver potentially higher returns for the member over the longer term, and potentially less risk through economic cycles. This is especially true for superannuation investments that are planned to have long duration
    c. Long term member outcomes are related to the fund performance, and also the economic growth and quality of living in Australia

driven by that economic growth. On the timeframes pertinent to Superannuation, individual superannuation balance at retirement is only part of the member outcome that should be considered, and superannuation investment in long term assets that drive long term economic growth outcomes in Australia are also impacted negatively by the distortions caused by the benchmark, especially in long-term asset investments (like nation building infrastructure and technology capability investment)

d. Others have argued[2] that long-term asset investment requires long term policy planning in OECD countries, and although we believe the benchmark will have negative impacts to long-term asset investments that are inherently national build infrastructure and technology capability investments in Australia, changing the benchmark will not be sufficient to improve superannuation investment in long term asset investment in Australia.

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?*
    a. No evidence, no response

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?*
    a. No evidence, no response

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?*
    a. No evidence, no response

8. *Are there any significant issues to be expected when the test is extended to TDPs? If so, how could these issues be addressed?*
    a. No evidence, no response

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?*
    a. No evidence, no response

YOURSUPER COMPARISON TOOL & STAPLING AND BEST FINANCIAL INTEREST DUTY QUESTIONS

We do not have any responses into the comparison tool review questions. We do not have any opinions into Stapling review questions

[2] How to foster investments in Long-Term Assets such as Infrastructure (2011)

SPECIFIC RECOMMENDATIONS REGARDING BEST INTERESTS DUTY GUIDANCE AND POLICY

Most superannuation schemes are trusts and therefore legally fall under the existing trust laws, and each state and territory have their own trust laws. A key and common feature of trust law is the fiduciary duty for the trust to act honestly and in good faith and in the best interests of the members of the trust.

This is underlined by the "statutory" duties of the Superannuation Industry (Supervision) Act 1993. It requires a super fund trustee, when formulating an investment strategy, to give regard to the risk and the likely return from the investments, diversification, liquidity, valuation, and other relevant factors.

The best financial interest duty guidance with regards to a trustee's investment strategy should have increased scope and incentive to consider:

a) Trustees making long-term infrastructure and technology investments, that lead to higher standards of living and better outcomes for members during retirement within that higher growth economy
b) Trustees making Environmental, Social, and Governance a larger consideration in the performance of the assets in which they invest, specifically seeing these as economic externalities that should be priced and costed into the asset's Profit/Loss and Balance sheets
c) Trustees actively supporting members to engage more in their superannuation investment strategy, enabling members to choose to have the trustees directly invest a percentage of their superannuation in assets of their choice, reducing the trustee's Best Financial Interest Duty

a) Trustees making long-term infrastructure and technology investments for Best Financial Interest Duty

There are many studies[3] which show that both public and private investment improves economic growth and thus standards of living in an economy. Equally, there are also many studies which show that levels of public investment (especially in developed countries) which are too high will crowd out private investment, having a negative impact on economic growth.

Over the ~40 year term of an Australian's working life, there is a strong argument that a faster growing economy over that 40 years will produce a better standard of living for that Australian, and the most effective way to stimulate higher growth is direct private investment in national building infrastructure in Australia.

[3] Multiple studies are described in this recent study into the Impact of Public and Private Investment on Economic Growth of Developing Countries (Ahamed - 2021)

Recommendation:

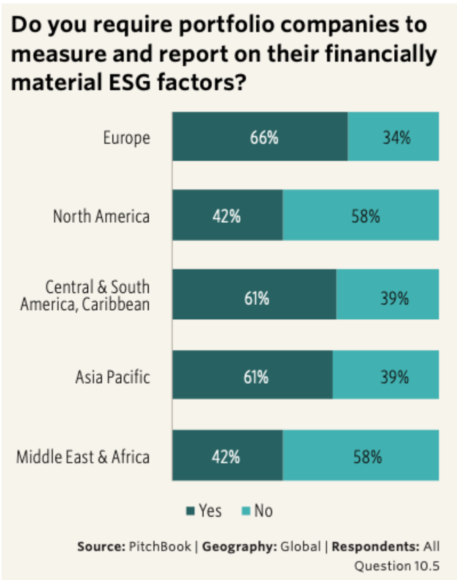
Changing the guidance that Best Financial Interest Duty for a trustee to include a strong consideration for more heavily investing in infrastructure and technologies at a scale which leads to higher levels of growth in the Australian economy, even where the investment is at a slight discount to the potential outcome of a similar investment overseas. The trustee should be able to illustrate empirically that these considerations have been made, and the trade-off of short-term portfolio return for the individual has been made over a longer-term investment in growth in Australia, and why it was justifiable, in an audit.

b) Trustees making Environmental, Social, and Governance a larger consideration of Best Financial Interest Duty

Over the period of 1996-2014, empirical evidence[4] of 29 OECD countries shows a strong positive relationship between countries with investment in ESG activities and performance and GDP per capita in the long term.

Greater GDP per capita leads to a better standard of living in the country on average, and greater individual incomes. The combination of larger individual incomes and improved standard of living delivers upon Best Financial Interest Duty for members and citizens of Australia at retirement.

APRA outlines in the Prudential Practice Guide (SPG 530, Investment Governance), that additional factors (such as ESG) can be incorporated into a best-interest investment strategy where there is no conflict with the requirements in the Superannuation Industry Act, including the requirement to act in the best interests of the beneficiaries.



ESG measurement and reporting is rapidly becoming a standard investment requirement globally, as shown by the research from Pitchbook[5]. The need for strong guidance in terms of Best Financial Interest Duty is something Superannuation trustees are coming to expect, and this is an area where the guidance should be apparent.

Recommendation:

Changing the guidance that Best Financial Interest Duty for a trustee to include a strong consideration for more heavily investing in companies that have strong and transparent Environmental, Social and Governance policies, plans and practices.

[4] ESG performance and economic growth: a panel co-integration analysis (Diaye – 2021)
[5] Pitchbook Sustainable Investment Survey 2022

c) Trustees actively supporting members to engage more in their superannuation investment strategy

In line with other recommendations in this document, the Government should look to guide trustees to take a broader perspective on Best Financial Interest Duty into investments have potential to drive long term growth in the Australian economy e.g. ESG positive, long term technology and infrastructure investments.

This following describes a policy designed to encourage everyday Australians to allocate part of their superannuation to long-term, large infrastructure and technology investment. Projects that are large enough that they are nation building and measured in the growth in the Australian economy that they need to improve. The proposed policy would encourage investment in two key ways:

- Firstly, by developing a priority list of long-term nation-building ESG aligned technology and infrastructure projects and investments, and
- Secondly, by providing an exemption to the 15% superannuation contribution tax when that contribution is directed to investments supporting those priority projects.

This will provide a simple and previously unavailable way for every Australian to choose to invest in nation-building clean energy infrastructure (from clean energy housing, smart cities and infrastructure to new technologies and capabilities for scale and export).

Increasing engagement of Australians in their superannuation, by giving them real choice in what they believe and want

The choice by individual Australians to invest, changes the balance of the Superannuation trustee's Best Financial Interest Duty, in that they broaden the scope of this duty to consider ESG positive and large-scale nation building project's positive impact of the long-term economic growth of Australia and the positive impact this has on the standard of living for members at retirement. The outcomes for an individual that has retirement funds is not as great as having retirements funds where those investments have also delivered a stronger and faster growing Australian economy, with a higher standard of living for all.

Democratising investment by giving members choice, provides the mandate for large scale nation-building investment

The tax-exempt superannuation contributions form a dedicated pool of long-term investment funds for investment in Australia, by Australians.

In quantitative terms, concessional superannuation guarantee contributions will total over $146.5 billion dollars in FY22[6]. While the total investment required for Australia to transition to a zero carbon economy is contested, considered observers such as the Commonwealth Bank consider the run rate

[6] ASFA Superannuation Statistics June 2022

to be $3 trillion over the next 30 years.[7] This proposed policy would provide a contribution towards the sustained investment required to drive long-term growth in the Australian economy as it transitions to a clean energy future.

While a tax exemption of this kind has an upfront cost to the budget, transitioning superannuation investment from non-productive asset classes into nation-building projects will increase economic activity in the short- to medium-term and economic capacity in the long-term which will, all things being equal, increase tax receipts and superannuation returns in the medium and long run.

Recommendation:

The Government could propose a policy that enables the ability for the member to instruct the trustee to make the direct investment in these Government sanctioned projects that removes the best financial interest duty of the trustee in those specific investments.

Further information on this potential Government Policy is available at the ADAPTOVATE website to download the document Accelerating investment in ESG positive infrastructure and technology in Australia

[7] AFR - Climate Transition requires $3 trillion: CBA - 10th August 2022

IMPORTANT NOTICE