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Superannuation Efficiency and Performance Unit
Retirement, Advice and Investment Division
Treasury
Langton Crescent
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By email: YFYS@treasury.gov.au

Review Board,

Re: Your Future, Your Super Review Submission

Amstelveen welcomes the opportunity to provide input into Treasury's review of the Your Future, Your Super (YFYS) measures.

In this submission we have identified three observations which we believe are worthy of consideration as part of this review, including that:

1. The current performance test methodology is likely to drive homogenisation of available funds and products;
2. The performance test may require modification for specialist funds, such as those with sector-specific or ethical mandates; and
3. The Best Financial Interests Duty (BFID) contributes to fund expenditure transparency, as a positive counter to legislative measures recently proposed by the Government which will reduce transparency in this area.

We describe these considerations in further detail below.

1. The current performance test methodology is likely to drive homogenisation of available funds and products

This consideration is relevant to Consultation Question #2.

The performance test methodology uses a passive benchmark portfolio matching a superannuation product's Strategic Asset Allocation (SAA) to measure performance. While a strong focus on returns is positive, the test only allows a narrow tolerance for underperformance of 0.5% over an 8-year period, or a compounded underperformance of about 0.062% per year.

If a product is found to be underperforming according to this benchmark, the Trustee is required to write to members using standard information prescribed in regulations. In this communication, members are prompted to consider switching to a different product and must be informed that the YourSuper comparison tool is available to help them to compare products. The Treasury Consultation Paper makes clear that the impact of underperformance is severe; funds identified as underperforming in 2021 experienced the closure of 10% of member accounts, and funds representing a further 70% of accounts were merged or in the process of merging with other funds.

The narrow requirement for being identified as underperforming and the magnitude of the actions required by the Trustees of underperforming products is a strong incentive for investment managers to allocate assets to investment options which closely mirror the benchmark. This is thus a strong driver for the homogenisation of investment strategies.

This assertion is supported by a study conducted jointly by the Association of Superannuation Funds of Australia (ASFA) and J.P. Morgan, in collaboration with executives representing a third of Australia Superannuation assets. This study involved a survey of the superannuation industry, in which 77% of respondents indicated that the performance test would result in funds allocating capital to assets with more benchmark-like returns[1].

This trend towards homogenisation has a number of downsides. It is likely to:

- Disincentivise funds from seeking outperformance for members – indeed the dramatic implications of failing the performance test creates a performance and consequence system external to simple investment risk and return. In some situations, the potential reputational risk of underperformance for a fund may even be considered with greater weight than the risk of relatively minor capital losses;
- Reduce diversity in the funds and products available to the public; and
- Increase the systemic risk associated with the large corpus of capital managed by the superannuation sector, due to funds being overweight and concentrated in benchmark-like products.

Options available to address the trend towards product homogenisation being driven by the performance test include increasing the underperformance tolerance and reducing the magnitude of consequences applied to underperforming funds.

[1] J.P. Morgan et. al., 'The Future of Superannuation: A Shared Perspective' (Report, J.P. Morgan, 2022), 13.

2. The performance test may require modification for specialist funds, such as those with sector-specific or ethical mandates

This observation is relevant to Consultation Questions #3 and #8.

The performance test's use of passive benchmarks portfolios to match the SAA of a fund is a simplistic mechanism which may not adequately accommodate specialist funds. This is particular the case for funds in which members have explicitly opted for the fund to target a specific investment approach, such as those with sector-specific strategies (e.g. the technology focus of Spaceship) or those which apply ethical or Environmental, Social and Governance (ESG) considerations in their investment strategies (e.g. Future Super, Australian Ethical, Australian Super – 'Socially Aware' option, UniSuper – 'Global Environmental Opportunities' option, ART – 'Socially Conscious Balanced' option, etc.).

The methodology could see funds rated as underperforming when this is simply a temporal characteristic of the investment intent of members and the over or underweighting of particular industries in a product. The performance test's methodology assumes that point-in-time underperformance is directly linked to the investment decisions of investment managers; this may be true over a very long time period and with homogenised portfolios, however in the shorter term this may be due to differences in the timing of asset return profiles, circumstantial events, or temporary market anomalies.

As an example, at the beginning of 2022, funds which had exposure to fossil-fuel production assets performed better than those which did not, due to short-term energy security issues caused by the war in Ukraine. The application of a performance test in this scenario would unfairly penalise ethically focused funds, when this variability may prove to be short term and members have expressed a clear desire for this investment strategy.

Worse still, the previously discussed investment strategy homogenisation driven by the performance test could actually result in funds which are marketed on an ethical basis reducing the strength of their investment bias towards these sectors. This would contribute to the phenomenon of 'greenwashing', a key concern of APRA and ASIC.

The solutions identified in consideration #1 above would contribute to addressing this observation. In addition, APRA could use benchmark portfolios which allow a more like-for-like comparison of outcomes by considering factors outside of the SAA, such as sector-targeting or ethical screens, as appropriate.

3. The Best Financial Interests Duty is a positive contributor to expenditure transparency

This observation is relevant to Consultation Question #17.

The ASFA and J.P. Morgan study identified that the BFID would result in less spending on discretionary expenses that do not have a direct member benefit[2]. Of those surveyed in the study, 55% indicated that

[2] Ibid, 11.

their funds would reduce sponsorship of employer/employee-related organisations, 43% will considering reducing corporate entertainment, and 38% will consider reducing advertising.

The BFID forces consideration of member financial interests, with negligent Trustees at personal risk of being found to be in breach of Trust. This is a positive development which should decrease overall fund administration costs, directly resulting in lower costs and better financial outcomes for members. This provides a strong counterbalance to the Government's recent proposal to reduce transparency in this area. This proposal involves removal of the requirement for itemised disclosure of payments to unions, industry bodies, trade associations, related parties and for marketing. Since such a legislative change will increase the opportunity for member funds to be used for purposes not directly benefiting members, the Duty should be maintained.

Thank you for providing us with the opportunity to provide input into the review of the YFYS measures. Please feel free to contact us to discuss any of these items in further detail.

Sincerely,

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