14 October 2022

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

SUBMISSION IN RESPONSE TO THE REVIEW OF YOUR FUTURE, YOUR SUPER MEASURES

Infrastructure Partnerships Australia is pleased to provide this submission in response to Federal Treasury's *Your Future, Your Super Review Consultation Paper*. The focus of this submission is on the performance test component of this Review.

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest.

Infrastructure Partnerships Australia's continued advocacy in relation to the Your Future, Your Super reforms aims to ensure the changes work in the best long-term interests of Australians who both use infrastructure and invest in it, either directly or through their superannuation.

This submission follows previous submissions Infrastructure Partnerships Australia has made in relation to the Your Future, Your Super (YFYS) reforms, including submissions in relation to the Draft Regulations in May and August 2021, and the Draft Legislation in December 2020. These submissions can be accessed here: www.infrastructure.org.au/submissions/.

Over recent months, Infrastructure Partnerships Australia has undertaken independent qualitative research of our infrastructure investors impacted by the YFYS reforms. Those interviewed include superannuation fund managers, infrastructure investors and developers, institutional investors and global investment advisors. The findings of this research are reflected in this submission.

High-performing superannuation supports high-performing infrastructure, and that benefits all Australians

As noted in Infrastructure Partnerships Australia's previous submissions, the infrastructure sector supports the Federal Government's broad aim of ensuring Australia has a high-performing superannuation sector. The policy objective of 'addressing underperformance in superannuation' is aligned with the objectives of Australian infrastructure investors, operators and users. Sound infrastructure investments benefits all stakeholders. In large part, the YFYS reforms appear to have been initially effective in supporting this objective, and this view is supported by the majority of investors we interviewed.

With its typically strong returns, stable policy and regulatory environment and sophisticated oversight, Australian infrastructure provides an excellent home for Australians' superannuation savings. In turn, a competitive and

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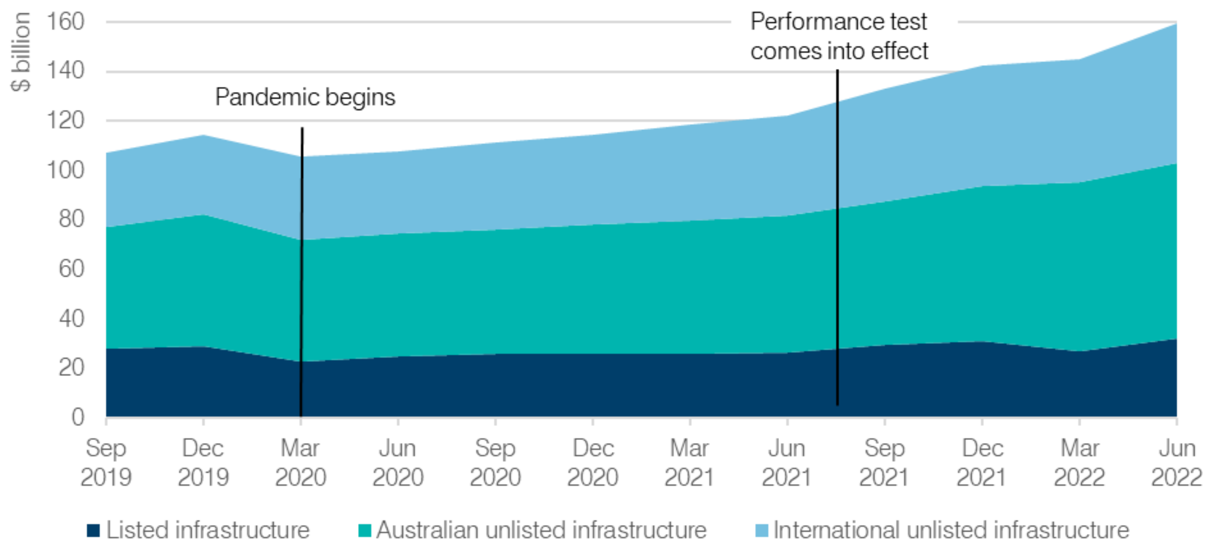
high-performing Australian superannuation sector supports a high-performing infrastructure sector. Strong investment appetite from the superannuation sector provides infrastructure with finance on competitive terms, as well as the expertise of sophisticated investors with a long-term focus that is well-aligned to long-lived assets.

These factors have underpinned remarkable growth in the value of Australians' investment in infrastructure through their superannuation. The total investment by Australian super funds in infrastructure has more than quadrupled within a decade, having grown from $36.6 billion in Q3 of 2013 to $159.9 billion in Q2 of 2022.[1] Much of this growth has been in Australian infrastructure, meaning more Australians are enjoying the benefits of the infrastructure their savings have helped to pay for today, while they also stand to benefit from these investments when they draw down on their superannuation.

Despite considerable change over recent years, superannuation investment in infrastructure continues to grow

Neither the impacts of COVID-19 nor the introduction of the YFYS performance test have dramatically altered this long-term trajectory of growth for Australian superannuation in infrastructure. As illustrated by Figure 1, the quantum of super in infrastructure has continued to grow over the past three years.

Figure 1: Australian superannuation industry infrastructure asset allocation



Source: Australian Prudential Regulation Authority, 2022

There is also no clear evidence of superannuation funds having divested from Australian infrastructure to overseas assets since the performance test came into effect. This is to the credit of Federal Treasury, having responded to the warnings of Infrastructure Partnerships Australia, among others, through previous rounds of YFYS by shifting to a more suitable infrastructure benchmark for the performance test and stepping back proposed changes to Portfolio Holdings Disclosure reporting obligations that could have underpinned a flight of capital from Australian infrastructure.

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[1] Australian Prudential Regulation Authority, 2022. *Quarterly Superannuation Performance: June 2022*.

Despite this growth, YFYS may still present challenges for Australian infrastructure

Throughout our advocacy on YFYS, Infrastructure Partnerships Australia has cautioned of the potential for unintended consequences to emerge. Despite the continued growth in infrastructure investment by superannuation funds, policy makers should remain alert to shifts in the underlying dynamics of Australian infrastructure investment as a result of the YFYS reforms. Infrastructure assets are typically illiquid, and changes in investment trends may take years to materialise in the aggregate data. But in a highly competitive and mobile global infrastructure investment market, a deterioration of investors' confidence in – or appetite for – Australian infrastructure could have major implications for the delivery of an infrastructure pipeline of unprecedented scale and complexity.

The majority of infrastructure investors we interviewed indicated the YFYS changes had not had a material impact on their portfolios. However, a number of key concerns emerged through our research about perceived or potential impacts of these reforms.

1. *The YFYS reforms may diminish super funds' appetite for Australian infrastructure*

Infrastructure investors we interviewed broadly supported the findings of the data above – that the appetite for Australian infrastructure has not been materially impacted by the YFYS reforms. However, there remain concerns from some that this trend may yet emerge, with one infrastructure investor and developer commenting, 'we are going to see a transformation of Australian super portfolio holdings be moved from domestic to offshore, with lower risk assets predominantly held offshore'.

In large part, these concerns are borne out of the composition of the infrastructure index used for the benchmark, which remains transport-heavy, concentrated, and potentially volatile. Policy makers should monitor the impact of the benchmark through fluctuations in the market to ensure these do not trigger a rush for assets that track the index at the expense of delivering long-term value for superannuation members.

2. *The performance benchmark may act as a deterrent for investment in certain asset classes*

The benchmark may result in a narrower focus by superannuation investors, as they move up the risk curve to meet the benchmark's hurdle rate of return. There remain fears that a shift in the relationship between risk and reward for superannuation funds as a subset of infrastructure investors could distort demand for core infrastructure. There may be a lack of incentive for superannuation investors to acquire or retain stable regulated assets and utilities with lower rates of return, which have previously been seen as critical for a resilient, diversified portfolio.

Similarly, the benchmark may act as a deterrent for investment in assets and funds tied to long-term outcomes, such as the energy transition and shift to net zero emissions. Some investors have noted reduced demand for Australian renewables, particularly for brownfield assets. This may be due to both the composition of the index – being transport-heavy – and investors' shift up the risk curve. If this trend continues, capital availability may be reduced for businesses looking to drive growth in these sectors, or could subdue the appetite of businesses to invest in their own transformation in line with ESG and net zero outcomes.

3. *YFYS may underpin a change in broader infrastructure investment dynamics*

Any changes in how and where superannuation funds invest in infrastructure will be amplified by the rapidly growing scale of the superannuation sector. For example, if the benchmark drives a narrowing focus in superannuation funds' demand for certain infrastructure asset classes, institutional investors and fund managers may seek to mirror these shifts in their own investments to ensure their investment products align with super funds' demands. Similarly, a reduction in demand for certain asset classes could shift the kinds of assets being brought to market, away from high-risk, high-yield, or in the case of privatisations, structured in a way that shifts risks that could be borne by investors back to taxpayers. If superannuation does shy away from some asset classes the cost or availability of capital for some Australian assets may be higher due to reduced competition.

Any further reforms should provide evolution rather than revolution, and leave time to adjust

Perspectives on whether there is appetite for further reform varied among the investors we interviewed. The majority were in favour of limited change to the existing approach. A number of investors expressed that, while the performance benchmark may not be perfect, it is not unreasonable. These respondents indicated the sector had adjusted to YFYS and will continue to adapt to the requirements of the performance benchmark. Among those seeking minor reforms, a number identified refinements to how RG 97 (in relation to performance fees) captures, defines and reports on costs.

Other investors suggested considering further adjustments to the benchmark. There is support among some investors for a shift to a CPI+ or bonds-plus based index, as this may be more in line with how super funds assess their portfolios and be less likely to underpin changes in demand for certain asset classes. Some suggested a shift to a benchmark that accounts for risk, or seeking to broaden the existing index to reduce biases. A composite approach was raised by some investors. However, support for how to change the benchmark is not universal and is likely to come with its own challenges and costs, particularly so soon after the existing approach was introduced.

Infrastructure Partnerships Australia commends the Federal Government on its implementation of this Review, and recommends Federal Treasury continues to monitor for, consult on and respond to any negative, unintended consequences of the YFYS reforms. Any potential for changes in the benchmark and/or how it is applied should be specifically consulted on, with an opportunity for infrastructure investors to provide comment and propose alternative approaches.

Throughout any discussion of further reforms, policy makers' primary focus should be on what will work best for the long-term interests of infrastructure users and superannuation members.

Infrastructure Partnerships Australia would be happy to provide more information

Infrastructure Partnerships Australia would be happy to provide further assistance to Treasury in relation to this Review. If you require additional detail or information, please do not hesitate to contact Mollie Matich, Director, Policy and Research, on (02) 9152 6000 or mollie.matich@infrastructure.org.au.

Yours Sincerely,

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