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14th October 2022

Australian Government, The Treasury
Langton Crescent
Parkes ACT 2600

Your Future, Your Super Review: Consultation Paper Responses

Wealth of Nations Impact Asset Management (WONIAM) was established at the end of 2021 and is a Corporate Authorised Representative under Wealth of Nations Advisors (WONA) AFSL no. 452804. WONIAM was borne out of the pandemic and driven by institutional investor demand for investment products that deliver market, or better than market investment returns, alongside positive measurable and verifiable social and/or environmental outcomes. We are a specialised fund management firm focused on impact investing, meeting the demand from super members and the beneficiaries of the largest intergenerational wealth transfer domestic and global in history. Millennials and Next Gens and their progressive value systems are changing the landscape for MySuper and WONIAM is at the forefront to support that transition. [www.WealthofNationsGroup.com.au]

Test Methodology

1. **Does the measurement of actual return using strategic asset allocation affect risk-taking behaviour by superannuation trustee?**

   If actual return is only relevant in relation to the benchmark return, then trustees will be inclined to reduce risk against that benchmark and 'hug' the benchmark. Any deviation from that benchmark increases risk and there is no reward for the additional risk taken. So relative risk is reduced, but market risk is significantly increased as it discourages any portfolio diversification – which is a key tenet of modern portfolio theory. An investor's ideal portfolio will be the one that maximizes their potential for return, while minimizing risk. There is no opportunity to maximise portfolio return.

   Alternative strategies are not in place to match a 50-50 benchmark of equities and bonds, they are there to provide diversification – risk protection - and deliver downside protection against those very asset classes. As alternatives will have a large tracking error against the benchmarks, trustees will avoid allocation to them, thereby exhibiting less relative risk-taking, but leaving members portfolios exposed against significant market drawdowns.

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?**

   Yes, undoubtedly. The indices are somewhat arbitrary and far from a one-size fits all solution. One vitally important point to address is the negative effect these indices are having on sustainable and impactful investing. Investing in sustainable and impactful investments are crucial in incorporating forward looking approaches to risk management in respect of negative environmental, social and governance outcomes. Moreover, these indices negatively impact a fund's ability to follow investment strategies that create positive environmental and social outcomes (in particular, impact investing). Importantly this is not exclusively "faith based", nor should it be in a secular democracy, however the use of these indices are prohibiting the use of more sustainable strategies where private capital can be put to use along with public capital to target a particular outcome (i.e., impact investments). There is scope to create more bespoke benchmarks however, the better approach might be to exclude truly impactful investments (which can be defined according to globally accepted metrics such as the IFC's Operating Principles for Impact Management, IRIS+ and others). Such an approach would align Australian super funds with their global peers to help shape capital movement to environmentally and socially beneficial and profitable investments. Solving the world's greatest problems will generate outsized returns, however Australian funds will miss out if this investment strategy (impact investing) is constrained to arbitrary and restrictive benchmarks.

   Australia's intergenerational wealth transfer from Boomers to Millennials will be huge over the next decade and a half. Most surveys point to Millennials and Next Gens wanting their investment capital to also deliver positive social and environmental outcomes, as well as market returns. Reducing choice will ultimately not be accepted by 'new' members.

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 stringent RAFE will demise value proposition of the test as it fails to consider non-financial outcomes in all their forms. For example, investment strategies under a sustainable or impact investing banner, deliver a range of non-pecuniary outcomes that investors are likely to value. And as it is a relatively new and growing industry, the investment management fees allocated to these types of projects may contain a higher fee even though they provide the same net return outcomes. Consideration of "impact" means investors see not simply a financial return (which can be at the detriment of society and the environment), but one that will drive economic returns with benefit to people and planet.

   RAFE is only relevant within the context of the actual return. If objective is to drive down fees for members and focus on financial returns, then net return is most relevant. If you have high fees, but high returns, it's the net that counts. If a RAFE benchmark was to be considered, it would be more appropriate to consider a MySuper weighted RAFE, based on the industry average, and funds are benchmarked against that. This would be the 'Operational Weighted RAFE'.

To cope with non-financial product features, consideration should be made for the creation of an 'Impact-Adjusted RAFE'. Highlighting fees directly related to benefit members. Attach a social or environmental value and avoidance of 'other benefits' not being quantified.

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?**

In the long-term we believe adherence to standardised indices will preserve the flow of capital towards investments that perpetuate activities that harm society and the environment. Long-term this will only detract from members outcomes and expectations. "There are no jobs on a dead planet" and "what sort of world do you want to retire into." More considerations must be given for strategies such as sustainable and impactful investing that are seeking to shape a better society and environment. Deploying capital in such a way only seeks to reduce "black swan" events, those that shock markets from societal and environmental shocks.

Utilising an 8-year lookback we have decided that 'past returns **are** predictors of future returns', the total opposite of ***'every'*** financial legal disclaimer that exists on the planet. We have taken a sample window where the world has operated in a near zero-inflation, zero-rate environment where every risk was hedged by central banks and underwritten by taxpayers. The last 8 months in financial markets has highlighted how flawed the performance tests are.

If super funds cannot invest capital for the long-term benefit of their members, and governments including our own, are too indebted to finance anything other than economic 'working capital', how will social and environmental issues be addressed? If our investment capital contributed to negative social outcomes, for example wealth inequality – and negative environmental outcomes, for example, climate change, then investment capital has the ability to also foster growth, when provided with a framework that supports, and not impedes, the flow of capital to address and solve those problems.

Consequences of Failure

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?**

We believe that the inclusion of impact outcomes in reporting would be beneficial to investors considering the outcomes of investments. Moreover, investors will be able to clearly identify if their values are being articulated in the outcomes generated by the funds. Such an approach is now ingrained into European markets through the Sustainable Finance Disclosure Regime and Taxonomy on sustainability. Similar rules are likely to come into place in the United States too. Once again Australian funds are falling behind global peers to the detriment of member transparency and outcome. Such reporting can be done in line with the United Nations Sustainable Development goals.

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?**

   Based on existing evidence, it appears there has been a greater drive for funds to merge than to improve. To improve the process, simply look at the economies of scale. Is a fund under $10billion viable? Economies of scale are most likely not there and will not benefit members. At the same time, has anybody asked the members of the funds what they want? Example, Christian Super has a large allocation to impact funds – its members invested in Christian Super based on its product offering and a longer-term view.

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?**

   If members are in an underperforming product, ask the members – what do they want to do. They may have made a conscious decision to be in the product, and to remain there, even if the product underperformed, given their expectation of return from that product over the long-term. The product may have matched their values – example – sustainable or impact investment.

Product Coverage

8. **Are there any significant issues to be expected when the test is extended to TDPs? If so, how could these issues be addressed?**

   No Comment

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?**

   We believe extending the current performance test to Choice Funds that have sustainable or impactful goals would mean the death of sustainable investing in Australian superannuation. One of the clearest areas where members have sought engagement with their super has been around sustainable themes. Choice funds have sought to allow investors choices to express their views through their super fund.

YourSuper Comparison Tool

10. Does the comparison tool adequately inform members and prompt a behavioural response? Is the tool effective at informing new employees of their options when entering the workforce, including those who do not have an existing superannuation account?

The focus of investing over the long-term should be on the net return. Having funds ranked by fees and cheapest first, seems to imply they are the best. So would rank by net return first. While BFID may direct an investors choice, it's a small history in time snapshot. The tool will have to adapt to include metrics covering the social and environmental impact of those returns.

11. To what extent would altered or additional metrics, or improved functionality, make the tool more effective while ensuring it remains simple and clear? What more can be done to ensure that new employees are able to choose high-performing superannuation product that are appropriate for their needs?

We believe that the reporting of impact outcomes in investor materials would be beneficial to employees when seeking the right super fund for them. In addition to financial reporting outcomes plan members should be permitted to access data on sustainability to ensure their choice of funds can align more broadly with their values. Such an approach is now ingrained into European markets through the Sustainable Finance Disclosure Regime and Taxonomy on sustainability. Similar rules are likely to come into place in the United States too. Once again Australian funds are falling behind global peers to the detriment of member transparency and outcome. Such reporting can be done in line with the United Nations Sustainable Development goals and other recognised metrics.

12. **As the test is applied to more superannuation products, should the comparison tool also be extended? Considering the volume and complexity of Choice products, how could the tool be extended in a way that is meaningful and digestible to members?**

A great number of Choice products include sustainability and impact focused funds. To effectively create a comparison tool, one will need to utilise a standardised methodology to report the social and environmental impact these products purport to deliver. True-to-Label impact investing through IRIS+, IMP theory of change, Operating Principles for Impact Investing, already provide those measurable and verifiable frameworks.

Stapling

13. To what extent are employers putting into practice processes to seek stapled fund details from the ATO? How has the implementation of stapling changed onboarding, software and payroll processes for new employees?

No comment

14. Are there any barriers in the current framework to achieve the intent of the stapling reform?

No Comment

15. What is the actual, or likely, impact of stapling on insurance coverage?

No Comment

Best Financial Interest Duty

16. To what extent has the BFID required trustees to change their processes and procedures? Has this caused any unintended consequences or impacted member outcomes in any way?

In our view the BFID is narrowly drafted to discourage trustees from being able to deploy sustainable investment strategies. We see no other reason for the enactment of this test (similar tests were brought into being in the United States by the Trump Administration). We believe the best interests of members are aligned with long term environmental and societal outcomes. Ultimately all members will pay for the costs of climate change and societal breakdown. These are not local issues but planetary and represent an unprecedented challenge for fiduciaries. Trustees should be able to consider long term risk factors in the consideration of an investor's best interests. There are grave consequences to preventing consideration of environmental and social matters as part of a forward-looking allocation and investment thesis.

17. **Are there certain types of expenditure or activity that trustees are particularly concerned about being able to prove compliance with the BFID in respect of? Why is it difficult to demonstrate compliance? Should there be a materiality threshold?**

Trustees consideration of environmental and social factors are being hampered by the BFID. This is arguably in conflict with their wider fiduciary duty and represents a litigation risk in the short term for trustees who arguably have conflicting duties.

18. Is the reverse onus of proof the most appropriate way to achieve the objective of improving member outcomes?

We believe this is very complex and fraught with problems as it aligns the trustees to only ever invest in the product or strategy that drives the greatest return at that point in time, as otherwise they will be exposed to legal interpretations of 'best financial interest'. If they take the impact of climate change into consideration as to the future return of their investment portfolio [given that current legal opinion in Australia has warned super funds that they could be sued if they did not. Example – REST Super] and within the timeframe of the investment, climate change does not impact the portfolio return as expected, it could be deemed that, with hindsight, they have failed the BFID. Does this improve member outcomes? Not if climate change does have the impact expected and the trustee took no action to take it into account. Remember, impact investing (true-to-label) does not impede BFID as the focus is dual – return and impact.

Contributors

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