

Response to request for feedback: Your Future, Your Super & the Australian inflation market

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TO The Treasury
FROM Westpac Institutional Bank, Financial Markets

This submission aims to provide feedback on how the YFYS act could be enhanced to better achieve the governments policy aims to improve performance and accountability in the Superannuation sector.

By benchmarking all AUD fixed interest investment to the Bloomberg AusBond Composite 0+ index, the YFYS Performance Test has inadvertently penalized legitimate investment decisions, exposing members to increased exposure to inflation, diminished optionality, and greater volatility. Investment in AUD inflation linked bonds is vulnerable to tracking error against this misaligned benchmark. There is outsized risk of fail for off-index bonds, which calls for the inclusion of an inflation benchmark. We propose The Bloomberg AusBond Infl Govt 0+ Yr Index.

Unintended Consequences of the YFYS Performance Test

The tracking error for AUD inflation linked bond investments by benchmarking against the AusBond Composite 0+ rather than an inflation benchmark has acted as a deterrent to investment in inflation bond product.

Consequences include:

1. Disincentive for fund managers to engage in inflation protected investment
2. Higher exposure to inflation for members, risking erosion of wealth over time
3. Reduced allocation to AUD inflation linked bonds
4. Reduced issuance of Treasury Indexed Bonds by AOFM due to lesser demand
5. Lower liquidity in the Australian inflation bond market
6. Greater volatility in AUD real yields
7. Market traded break-even inflation is considered a term measure of inflation, used in decision making by many including by the RBA. Greater volatility in real yields could distort market priced inflation, impeding decision making for many.

Importance of inflation product to retirement investment

Inflation linked bonds are specifically designed to protect investors from the corrosive effect of inflation on wealth over the long term. They increase in value during periods of high inflation and as such, provide a unique opportunity to simultaneously grow wealth, maintain purchasing power and defend investment against inflation. For this reason, inflation linked bonds are favoured globally by pension funds, insurance funds and other institutions with long term investments.

We are currently in a period of very high inflation, a time when members should not be deterred from engaging in inflation protection. In periods of low growth and high inflation (stagflation) inflation linked bonds are one of few investments which perform.

Inflation linked bonds returns have low correlation with equities and other fixed income assets making them strong candidates for diversification.

The *Retirement Income Covenant*, implemented 1st July 2022, identifies inflation as a key risk to the sustainability and stability of retirement income. When constructing an effective long term superannuation portfolio, inflation protection is an important investment option for superannuation funds to protect members retirement income from inflation risk. Under YFYS, the availability of only one fixed income index disincentivises superannuation funds from investing in a number of strategies that can be in the best interests of their customers. In particular it makes it impractical to own inflation protection and inadvertently challenges liquidity and stability in the inflation bond market. This puts the unintended impacts of YFYS, as outlined above, in opposition to the aims of the Retirement Income Covenant.

Recommendation

There are several existing indexes that are readily available and already used to benchmark inflation investment portfolios.

We propose an expansion of the *Covered Asset Classes* to include a further item: **Australian Inflation Linked Fixed Interest** with an index of **The Bloomberg AusBond Infl Govt 0+ Yr Index**. Assumed annual fee and assumed taxation to be in line with the existing nominal fixed interest benchmark at 0.10% & 15.0% respectively.

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Appendix

1. Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021
<https://www.legislation.gov.au/Details/F2021L01077>

9AB.17 Meaning of covered asset class, assumed index, assumed annual fee and assumed rate of tax

(7) The table is as follows:

Covered asset classes, assumed indices, assumed annual fees and assumed tax rates for quarters starting on or after 1 July 2014				
Item	Description	Assumed index	Assumed annual fee	Assumed annual rate of tax
1	Australian Equity	ASA52 S&P/ASX 300 Total Return Index	0.05%	0.00%
2	International Equity (hedged)	DE725341 MSCI All Country World Ex-Australia Equities Index with Special Tax (100% hedged to AUD)	0.11%	14.00%
3	International Equity (unhedged)	DN714533 MSCI All Country World Ex-Australia Equities Index with Special Tax (unhedged in AUD)	0.09%	14.00%
4	Australian Listed Property	ASA6PROP S&P/ASX 300 A-REIT Total Return Index	0.12%	14.00%
5	International Listed Property	RAHRSAH FTSE EPRA Nareit Developed ex Aus Rental 100% Hedged to AUD Net Tax (Super) Index	0.22%	14.00%
6	Australian Listed Infrastructure	FDCIISAH FTSE Developed Core Infrastructure 100% Hedged to AUD Net Tax (Super) Index	0.26%	14.00%
7	International Listed Infrastructure	FDCIISAH FTSE Developed Core Infrastructure 100% Hedged to AUD Net Tax (Super) Index	0.26%	14.00%
8	Australian Unlisted Property	MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index – NAV-Weighted Post-Fee Total Return (All Funds)	0%	14.00%
9	International Unlisted Property	MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index – NAV-Weighted Post-Fee Total Return (All Funds)	0%	14.00%
10	Australian Unlisted Infrastructure	MSCI Australia Quarterly Private Infrastructure Fund Index (Unfrozen) – NAV-Weighted Post-Fee Total Return (All Funds)	0%	14.00%
11	International Unlisted Infrastructure	MSCI Australia Quarterly Private Infrastructure Fund Index (Unfrozen) – Nav-Weighted Post-Fee Total Return (All Funds)	0%	14.00%
12	Australian Fixed Interest	BACM0 Bloomberg Ausbond Composite 0+ Yr Index	0.10%	15.00%
13	International Fixed Interest	LEGATRAH Bloomberg Barclays Global Aggregate Index (hedged to AUD)	0.10%	15.00%
14	Australian Cash	BAUBIL Bloomberg Ausbond Bank Bill Index	0.04%	15.00%
15	International Cash	BAUBIL Bloomberg Ausbond Bank Bill Index	0.04%	15.00%
16	Other/Commodities		0.10%	14.50%

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2. The Bloomberg AusBond Infl Govt 0+ Yr Index

IGPO UKTI 0 1/8 08... MDM AUST 10Y BON... BNDX Bloomberg E X DES BBG AUB Comp ...

GO F1 F2 F3 F4 PRINT HELP MEMC SEARC QUOT QUOT MONI NEWS MSG MENU PG BA PG FV FWCN GMM

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BAIGO Index Download Functions Security Description

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Bloomberg AusBond Infl Govt 0+ Yr Index

The Bloomberg AusBond Infl Govt 0+ Yr Index is engineered to measure the market of inflation-linked bonds issued by the Govt and Semi-Govt Authorities of Australia. This is a legacy UBS index and is a subset of the Bloomberg AusBond Master Index. It is a rules-based, market value weighted index which includes bonds maturing in 0+ years. [BBGID BBG006SCN HK4]

5) Total Return Chart (GP)

Index Information

Inception Date	3/31/1991	Index Type	AusBond
Base Currency	AUD	Market Type	Developed Market
Rebal Frequency	Monthly	Next Rebal Date	10/31/2022
Weighting	Market Value		
Forward Characteristics (10/11/2022)			
Yield To Maturity	1.51	Mac Duration	8.14
Mod Convexity	1.08	Spread Duration	7.97
Mod Duration	8.1	Average Life	9.15 Yrs
Members	14	Quality	AAA
Market Cap.	51.74B		

Return	Date	Level	% Chg
Month to Date	09/30/22	7139.92	-0.48
Year to Date	12/31/21	8283.01	-14.21
1 Year	10/11/21	8098.68	-12.26
3 Years (Ann)	10/11/19	7701.72	-2.65
52 Weeks High	12/29/21	8357.54	--
52 Weeks Low	06/15/22	6986.06	--

Top Weighted Constituents			
Name	Wgt(%)	Name	Wgt(%)
1) ACGB 3 09/20/25	22.19	1) ACGB 1 3/4 08/21/40	8.24
2) ACGB 2 3/4 09/20/30	17.49	2) ACGB 0 3/4 11/21/32	6.89
3) ACGB 0 3/4 11/21/27	13.71	3) ACGB 1 02/21/50	6.84
4) ACGB 2 08/21/35	10.30	4) NSWTC 2 3/2 11/20/35	3.10
5) NSWTC 2 3/4 11/20/25	8.51	5) AUSCAP 0 06/12/48	0.85

Suggested Functions GP Chart securities & technical studies PCS Choose your preferred pricing sources