



2 May 2023

RE: Your Future, Your Super Exposure Draft Regulations

Dear Sir/Madam,

AMP appreciates the opportunity to make a submission in relation to the Your Future, Your Super (YFYS) Exposure Draft Regulations and Explanatory Material released on 4 April 2023.

We have contributed to the FSC and ASFA submissions in relation to the Exposure Draft Regulations.

There are, however, several specific concerns that AMP particularly wishes to accentuate, and these are the focus of this submission.

The proposed approach and methodology for performance testing Trustee Directed Products (TDPs) on superannuation wrap platforms will result in damaging impacts for members, financial advisers and the superannuation system and will lead to significant consumer harm. The proposed approach:

- does not reflect actual member experience so will provide misleading and confusing results to members;
- does not provide sufficient information or warnings in the notice given to members holding a product that fails the test to support these members to make informed decisions that are in their best financial interests and as such members could be significantly worse off if they pursue the action recommended in the notice;
- unjustifiably erodes confidence in the advice industry by intruding upon the role of advisers to recommend suitable financial products, as part of a comprehensive and holistic strategy based on a member's personal circumstances, and in consideration of a range of factors including the product's objectives as stated in the PDS and TMD; its risk, return and diversification characterises as part of a broader portfolio strategy (as opposed to performance against the prescribed benchmarks used for the performance test);
- unfairly penalises super fund trustees that, in the absence of tax relief which would otherwise allow members to be transferred to an alternate product, have already taken reasonable steps in consideration of members' best financial interests, to appropriately manage underperforming products by closing the product to new members; and
- discriminates against products designed to achieve specific and important objectives in a member's investment portfolio, such as managing volatility; supporting hedging strategies or generating income, due to test outcomes being based solely on net return and this will discourage product innovation, leading to reduced competition and reduced choice for consumers.

To ensure performance test outcomes for superannuation wrap products reflect actual member experience and do not lead to significant consumer harm:

- Performance testing should not be extended in 2023 to a limited sub-set of multi-sector options available on superannuation wrap platforms. The test should be extended to trustee-directed and externally directed wrap products simultaneously.

- Capital gains tax rollover relief must be extended to apply to a trustee directed transfer of members between individual investment options within a superannuation fund.
- Investment options already closed to new members should not be subject to consequences of failing the performance assessment (as the consequence has already been applied by the Trustee).
- For investment options with multiple pathways, each pathway should be tested separately with consequences limited to the specific pathway.
- A relevant proportion of the account level dollar-based administration fee should be assessed for Choice options on the basis that an average member holds multiple options.

On balance, the extension of YFYS performance testing to TDPs, as outlined in these regulations, will cause meaningful harm to consumers, and will undermine businesses on the basis of their performance against a mismatched benchmark. As such, AMP encourages Treasury to consider our concerns outlined in the attached submission.

If you have any questions or would like to discuss the content of our submission further, please contact me on 0412 437 315 or Scott Hartley on 0413 026 748.

Yours sincerely



Alastair Kinloch
Director of Government Affairs and Public Policy, AMP Ltd.



**Members Outcomes and Governance Branch
Retirement Advice and Investment Division
Treasury**

Your Future, Your Super Exposure Draft Regulations

AMP Ltd. Submission

2 May 2023



1. Wrap products are inherently different to other superannuation products

Superannuation wrap products are inherently different in nature and use to both MySuper products and simple Choice products that are comparable to MySuper products. The performance test as currently proposed fails to fully recognise the nature and use of wrap products and will therefore provide misleading results and cause significant harm to members holding these products.

MySuper products are simple, low-cost products suitable to serve the needs of members who have not made an active choice about how to invest their superannuation. Most members in MySuper products have not received financial advice. MySuper products are rightly subject to a higher level of regulation than Choice products and it is appropriate that they are also subject to a strict performance test with clear consequences.

Choice products with pooled investment arrangements (non-wrap products) offer members a range of simple diversified multi-sector investment options. Most members have not received financial advice and typically invest their entire superannuation in one or two of these options (members in AMP's non-wrap super product hold two Choice investment options on average). These simple Choice products are comparable to MySuper products and therefore extending the current objective benchmark performance test to these products would be appropriate.

Superannuation wrap products offers an extensive menu of investment choices wrapped up in a single account. These products are designed for members with more complex investment needs and a desire for more diverse choice and more control over their superannuation.

Access to many wrap platforms is only available to retail clients for the purpose of implementing personal advice. Even where direct access is available, a member's decision to invest in a product offered on a wrap platform is most often informed by financial advice based on an alignment of the product's stated objectives with the member's personal circumstances, needs and objectives. The current objective benchmark test does not recognise performance against these product objectives as disclosed to members in the PDS and TMD.

An investment option on a wrap platform will not generally be used in isolation but rather the member, assisted by their financial adviser, will use a blend of options to create an appropriate investment portfolio. By viewing an investment option in isolation, the performance test therefore fails to recognise the way in which products on a wrap platform are generally used.

Unlike non-wrap products which apportion taxes and fees equally across all members through adjustments to the unit price, for a wrap product taxes and fees are unbundled and applied at the account level based on the member's actual transactions.

2. A phased approach for testing wrap products will cause consumer harm

Under the proposed approach, only a very small proportion of multi-sector investment options offered on wrap platforms will be tested in 2023 because most wrap options will be excluded on the basis that they are not managed by a connected entity of the trustee.

This means that all members invested in a particular product will not be treated equally. For example, a multi-sector investment option may be tested on a particular wrap platform (because the trustee and RE or investment manager are connected entities) but the same option will not be tested on other platforms. If the option fails the test, only members invested via the 'connected entity' platform will receive a notice that the product is underperforming and will have the opportunity to exit the product earlier, to the potential detriment of remaining investors.

In addition, this approach will not provide members and financial advisers with certainty and confidence about the performance outcomes of alternate wrap products they may consider where an existing product fails the test and may result in members moving to an alternate product that would have also failed the test had it applied. This may lead to a member incurring unnecessary friction costs (eg, advice costs, buy/sell spreads, CGT) due to moving benefits multiple times as the scope of the performance test is extended in future years.

For these reasons, we strongly caution against applying the test to only a sub-set of wrap platform products in 2023.

Recommendation 1:

The performance test should be extended to trustee-directed and externally directed wrap investment options at the same time. This should only occur after APRA has collected sufficient data and has completed appropriate quality assurance with respect to this data to provide confidence in the accuracy of the test outcomes.

3. Consequence management for Choice products

2.1 CGT relief required to facilitate closure of underperforming Choice products

Currently, Capital Gains Tax (CGT) rollover relief is available where an entire superannuation fund merges with a different fund. This relief has facilitated recent fund mergers in response to MySuper performance test outcomes.

Where one or more Choice investment options fails the performance test it is highly unlikely that this outcome alone would warrant a superannuation fund merger.

Where performance issues are identified with respect to a Choice investment option, a trustee may determine that performance could be improved by transferring members to another investment option in the fund. However, no CGT rollover relief is currently available for a trustee directed transfer of assets of an identifiable product or investment option within a superannuation fund.

In the absence of tax relief, one of two scenarios will play out in superannuation wraps both of which will cause consumer harm. That is either members will pay CGT (when they otherwise would not) or they remain in investment options that have failed the performance test. The below paragraphs elaborate on this.

If members are switched from one investment option to another, CGT liabilities that would otherwise only be payable on the later sale of the assets (or not at all with the move to pension phase) will be brought forward resulting in members incurring tax on any capital gains arising from the sale of the underlying assets. It is often the case these adverse member tax consequences and costs to switch outweigh any positive performance and risk outcomes which means closing the option and transferring members to an alternate option in the fund is not desirable as this will not be in members' best financial interests.

A case study provided in Attachment A to this submission demonstrates the adverse member tax consequences and potential costs involved in moving to a different product.

The absence of CGT relief for a trustee directed transfer of assets of an investment option within the fund significantly limits trustees' ability to manage underperforming investment options in the best financial interests of all members holding the option. The adverse member tax consequences that apply in the absence of this relief is a barrier to financial advisers recommending that an individual member transfers to another investment option, product, or fund. This lack of tax relief can therefore often result in effectively locking existing members into legacy products that have been closed to new members.

The lack of CGT rollover relief at the investment option level within the fund is also an impediment to simplification and rationalisation of underlying investment structures for wrap platform products. As identified by APRA, proliferation of investment options can result in cost inefficiencies for trustees which can contribute to sub-optimal outcomes for members.¹

Providing CGT rollover relief for a trustee directed transfer of assets of an identifiable product or investment option within a superannuation fund will provide Trustees with the ability to transfer all members in underperforming products (as defined by the performance test) to an alternate better performing product in the fund, without the significant member harm. This would have the following advantages compared with the current approach to consequence management:

- no adverse tax consequences for members,
- no unnecessary advice costs for members,
- does not risk intruding upon the role of the financial adviser and undermining confidence in Advice,
- allows Trustees to protect members from underperforming products beyond the scope of those subject to performance testing, and
- reduction in proliferation of Choice products resulting in improved efficiency and lower costs for members.

¹ APRA Information Paper, *Choice sector performance: improving outcomes for superannuation members*, October 2021.

This would not result in forgone tax revenue for the Government as members will tend to remain in underperforming investment options rather than trigger a significant tax event. This is evidenced by the number of closed options in wrap platforms today.

Recommendation 2:

Before extending the performance test to superannuation wrap products, CGT rollover relief must be extended to apply to a trustee directed transfer between investment options in the same fund.

2.2 Products already closed to new members should not be subject to further consequences

Further to the above section, where a Trustee has taken all steps reasonably within its control and available under existing superannuation and tax law to appropriately manage an underperforming product, no further consequences should apply if that product fails the performance test.

In the absence of CGT rollover relief at the investment option level, members would be subject to adverse tax consequences if the Trustee transferred underlying assets to an alternate option in the fund. This action is unlikely to be in members' best financial interests. Accordingly, it would not be reasonable to expect the Trustee to have done this.

In consideration of this, reasonable steps would typically include:

- closing the product to new members, and
- notifying existing members holding the product, and advisers with clients holding the product, that the Trustee has determined based on a range of factors, including but not limited to performance, that the product no longer meets the minimum criteria for ongoing suitability and will be closed to new members.

These reasonable steps are equivalent to the consequences for failing the performance test in two consecutive years. Considering this, it is difficult to see how applying the current consequences for failing the test provides any further benefit or protection to members. Instead, this could cause confusion and result in members incurring unnecessary advice costs.

This would also intrude on the role of the adviser who upon receiving earlier notice of the product being closed to new members would have already reviewed their client's portfolio based on a range of relevant factors and recommended a suitable course of action consistent with the client's personal circumstances, needs and objectives.

If it is determined that consequences are to be applied to investment options or pathways closed to new members, these should be separate and different to the consequences that apply where a product that is open to new members fails the test. The consequences applied to products closed to new members should be modified to recognise and address the issues outlined above. For example:

- A modified version of the prescribed notice should be given to these members including a clear recommendation to seek advice about potential adverse tax consequences that may apply if the member moves their money to a different product.
- Public disclosure of performance test results for options and pathways closed to new members should be separate to disclosure of results for open products and should include an explanation of the barriers preventing a trustee-directed transfer to an alternate product.

Recommendation 3:

Where a Trustee has already closed an underperforming product to new members and has notified members holding the product and their financial advisers of this, no further consequences should apply if that product fails the performance test.

Any consequences for products closed to new members should be separate and must appropriately address the barriers preventing a trustee-directed transfer of members to an alternate product and the potential adverse tax consequences for members on transferring to an alternate product.

3.3 The member notice must include a clear warning about potential taxes and costs

The notice Trustees are required to give to members holding a product that fails the performance test advises the member that they should consider moving their money to a different super product and indicates that this 'is easy and there are no fees'.

This is misleading because while there are no exit fees, members may incur significant tax liability and other costs if they move their money to a different super product.

If a member decides to move their money to another product, they may incur:

- tax on capital gains arising from the sale or transfer of assets (for wrap products, tax payable is generally deducted from the members account and in a pooled super fund this is reflected in the unit price, the difference being in wraps there is a real and adverse impact on members balance, this is not the case with members balances in pooled super funds)
- financial loss due to buy/sell spreads (unless assets are transferred in specie)
- transaction fees where assets are transferred in specie
- costs for financial advice in relation to the transfer
- additional tax due to loss of entitlements to franking credits where shares have not been held by the fund for 45 days (45-day rule applies based on the last purchase by the fund irrespective of when the member acquired their interest)
- stamp duty costs
- brokerage costs

If the entire benefit is moved, the member may lose insurance benefits and may not be able to obtain cover at the same level or cost in the new super fund.

ASIC's Report on its review of trustee communications about the MySuper performance test (REP 729) notes that 'undue prominence should not be given to benefits over risks or advantages over disadvantages'. The notice trustees are required to give members holding a product that fails the performance test arguably provides undue prominence to the benefits of moving money to a different product over the potential risks and costs that may be involved.

Recommendation 4:

The notice Trustees are required to give to members holding a wrap product that fails the performance test should include a clear warning about potential tax liability and other costs the member may incur upon moving their money to a different super product. The notice should also suggest that the member considers seeking professional tax advice and/or financial advice.

4. Methodology for performance testing superannuation wrap products

3.1 Products with multiple investment pathways

The Draft Regulations propose that where a product that is subject to the performance test has multiple investment pathways, that product will be tested based on the asset-weighted average of the standard (highest) administration fee for each pathway and the lowest actual return (highest investment fee) across all pathways.

This proposed approach does not reflect actual member experience and therefore performance test results will be confusing and misleading. It will lead to significant consumer harm by virtue of members acting on inaccurate test results or failing to take action due to lack of awareness.

- Members invested in a pathway that would have passed the performance test if assessed separately will receive a 'fail' notice recommending that they consider a different product.
- Members in a pathway that would have failed the test if assessed separately will not receive notice that the pathway in which they are invested has failed the performance test.

Disclosure of inaccurate performance test results for products with multiple investment pathways will undermine confidence in Advice and ultimately significantly increase the cost of advice as members need to consult their adviser to consider alternate investment strategies.

It will be extremely difficult for financial advisers to balance the recommendation in the notice to consider moving to a different product with their best interest duty where the adviser determines that based on the actual performance for the particular investment pathway, it is in the members best interest to remain invested in that pathway.

Recommendation 5:

Where an investment option has multiple investment pathways, each pathway should be tested separately with consequences limited to the specific pathway.

3.2 Assessment of administration fees for Choice products

Dollar based administration fees for Choice products apply at the account level. As such, assessing the full value of the dollar-based administration fee for each investment option is not reasonable and will not reflect current or likely future member outcomes. This is different to MySuper members which almost always have their whole balance invested in the MySuper investment option.

For accumulation super accounts on AMP's wrap platform for example, an average of seven investment options are held. For accounts in Master Trust, an average of two Choice investment options are held (some members may also hold the MySuper option). We believe these averages will be reasonably representative of industry, although other wraps may have a higher average number of investment choices per account.

For Choice products, assessing a representative proportion of the total dollar-based administration fee based on the average number of investment options held by members in the particular product type would provide more accurate and meaningful performance test outcomes for members holding these products.

While data currently collected by APRA does not specifically distinguish between different types of Choice products, we believe different product types could be identified based on *return measurement* values. For example, superannuation wrap products would report *gross investment return net of fees* and non-wrap products would report *net investment return*.

Recommendation 6:

The performance test for Trustee-Directed Products, and additional Choice products that may be tested in future, should assess a representative proportion of the dollar-based administration fee based on the average number of investment options a member holds.

We suggest that a representative proportion of 20% for wrap products and 50% for non-wrap products would be appropriate.

3.3 Tax adjustment for wrap options

Pooled superannuation products typically reflect tax, including any post-tax benefits such as franking credits, through adjustments to unit prices for underlying investment options. In this way, the tax liability for transactions made on behalf of members holding a particular option is distributed across all members holding that option irrespective of individual member transactions. This allows for net investment returns (after fees and after tax) to be reported for the underlying investment options.

For superannuation wrap products, tax is unbundled and applied at the member account level based on the member's actual transactions. As a result, it is not possible to report a 'net investment return' (NIR) at the investment option level. For these options, 'gross investment return net of fees' (GIRNF) is reported instead.

The Draft Regulations propose that where GIRNF is reported for a product, a tax adjustment intended to mirror the assumed tax rates for the relevant covered asset classes will be applied to derive a NIR for the purposes of the performance test.

This proposed approach does not recognise the value of post-tax benefits attributable to certain investment options such as franking credits which result in higher after-tax returns. This means that superannuation wrap

products are treated unfavourably compared with pooled superannuation products for the purposes of performance testing.

Adjusting the GIRNF to include the post-tax benefit of actual franking credits distributed for each wrap investment option would provide more accurate performance test outcomes that are more reflective of actual member experience.

The application of the proposed tax adjustment also results in outsized and non-sensical quarterly returns in certain circumstances. As illustrated in the table below, for quarters where the post-tax benchmark return is close to zero, the proposed formula for deriving NIR generates a materially large ratio, which when multiplied by the 'gross investment return net of fees' results in an outsized quarterly return.

Quarter ending	Step 1	Step 2	Step 3	Step 4	Step 5
	Quarterly SAA Weighted Benchmark return net of fees & tax $\frac{\sum_{a=1}^A \{SAA_{a,t+1} \times [Index_{a,t} \times (1 - ART_{a,t})]\}}{\sum_{a=1}^A \{SAA_{a,t+1} \times Index_{a,t}\}}$	Quarterly SAA Weighted Benchmark return net of fees $\sum_{a=1}^A \{SAA_{a,t+1} \times Index_{a,t}\}$	Tax Ratio (Step 1 / Step 2)	GIRNF	Derived NIR (Step 4 x Step 3)
31/12/2016	0.07%	0.0029%	2366.23%	2.402%	56.84%
31/03/2017	2.00%	2.27%	88.03%	2.070%	1.82%
30/09/2021	0.02%	0.00%	-10411.20%	0.848%	-88.32%

These outsized quarterly returns will generate outsized and non-sensical performance test outcomes which will be misleading and result in significant consumer harm.

Applying the test on a pre-tax basis would resolve this technical issue and therefore generate more accurate performance test outcomes.

Recommendation 7:

Where 'gross investment return net of fees' (GIRNF) is reported for a product:

- the GIRNF should be adjusted to include the value of franking credits distributed for that product, and
- the performance test for that product should be completed on a pre-tax basis.

Attachment A

Jimmy is an advised super wrap platform member aged 54

He holds a failing TDP totalling 98% of his portfolio which he decides to move his super to a new super fund, resulting in the following consequences:

Investment	Type	Total value	% of total	Test Result
Cash Account	Direct	\$47,945.96	1.97%	
High Growth Investment Fund	TDP	\$2,389,076.16	98.03%	Fail
Total		\$2,437,022.12	100%	

* Assuming upswing of 6% based on balanced funds. Note he may have also avoided losses if the markets moved lower.

^ This is based on the buy spread of a similar investment option (15bps)

Implications for Jimmy:

Jimmy loses confidence in his existing adviser and obtains advice from a new adviser which costs him \$5,000

Jimmy incurs sell spread costs of \$3,345

Jimmy will be subject to a capital gain of \$380,000 and must pay tax of \$38,000 (this would not otherwise be payable after commencing a pension on retirement on or after age 60)

Jimmy will have forgone earnings of approximately \$2,919 pa due to all costs related to the transaction

Jimmy is out of the market for 4 weeks as he moves to a new super fund and misses out on a significant market correction where he could have had gained \$11,026*

Jimmy has to pay buy spreads of approximately \$3,500^

The financial loss to Jimmy as a result of the underperformance of the failing products is \$14,334 which represents 0.58% of his total return.

As a result, Jimmy incurs costs of \$54,571 in the first year which represents a total impact of 2.2% of his total return.

There are 290 members invested in the failing fund. Of these, 40 members are in a similar position to Jimmy and if they decide to sell they will incur a combined tax liability of \$417,000.

The Trustee closes the failed TDP to new members but determines it is not in members' best financial interests to transfer existing members to an alternate product as CGT and costs to switch outweigh performance and risk outcomes for the members. The Trustee is unable to influence future performance or asset allocation of the closed TDP. The Responsible Entity (RE) of the underlying investment has a legal obligation to act solely in the best interests of its unit holders (including super and non-super investors) and is prohibited from acting on a direction from the Trustee.