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2 May 2023

Subject: Exposure Draft Regulations - Your Future Your Super

Dear Luke

Mercer welcomes the opportunity to comment on the Exposure Draft Regulations relating to the annual superannuation performance tests released by Treasury on 4 April 2023.

The structure of this submission is as follows:

- Who is Mercer?
- Our major comments and recommendations
- Benchmarks
- Notification letter

Who is Mercer?

Mercer believes in building brighter futures by redefining the world of work, reshaping retirement and investment outcomes, and unlocking real health and well-being. Mercer's approximately 25,000 employees are based in 43 countries and the firm operates in 130 countries. Mercer is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people, with 85,000 colleagues and annual revenue of over \$20 billion. Through its market-leading businesses including Marsh, Guy Carpenter, Mercer and Oliver Wyman, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment.

Our major comments and recommendations

Mercer supports the:

- progressive increase in the testing period from eight to ten years; and
- disaggregation of some of the previous benchmarks to better reflect the different investment opportunities available to the trustees of superannuation funds.

However, to further improve the performance tests, Mercer recommends the:

- introduction of two new equity indices reflecting low volatility investments and small-micro cap stocks
- replacement of a number of the proposed infrastructure indexes with others that are better suited to the relevant asset class
- replacement of the proposed index for international credit with a more comprehensive index.

Mercer also recommends that the Regulations relating to the notification letter under Schedule 2A be revised to recognise that a revised letter is necessary for members who have money in a failed Trustee Directed Product compared to those with money in a failed MySuper product.

Benchmarks

It is important that the benchmarks used within the performance test are appropriate. This is to ensure that the benchmarks do not encourage superannuation fund trustees from avoiding or reducing exposure to certain investments due to the likelihood of significant tracking error from the proposed benchmarks. Mercer therefore recommends the following changes to the proposed benchmarks:

- *Equity portfolios:* Many superannuation fund members, and particularly those approaching retirement, are seeking to minimise risk by seeking low volatility investments. Therefore, we believe there should be recognition of this desirable outcome through the introduction of a benchmark using the MSCI World Minimum Volatility Index. The use of a low volatility index would become even more important should the performance test be extended to retirement products.
- *Australian Equity:* Introduction of a small-micro cap index for Australian equities while retaining the proposed ASX 300 Index for the balance of the Australian Equity portfolio. The introduction of this index would provide an incentive for super funds to invest in this sector of the market.
- *Australian and International Listed Infrastructure:* Replacement of the FTSE Developed Core Infrastructure 100% Hedged Index with the FTSE Global Core Infrastructure 50/50 Index. This index better reflects the benchmark widely used within the industry and would require limited change.
- *International Unlisted Infrastructure:* Replacement of the MSCI Australian Quarterly Private Infrastructure Fund Index with the MSCI Global Quarterly Private Infrastructure Asset Index as it is more appropriate as there are material differences between Australian and international infrastructure investments. That is, it makes little sense to use an Australian-based index to

benchmark performance when investing internationally. Adopting the median index outcome would also assist in ameliorating the potential benchmark impact of performance generated by a small number of funds included in the index, in view of the index being relatively concentrated in certain respects.

- *Australian Fixed Income*: We note that the revised index now includes inflation-linked and floating rate credit. However, it would be preferable to have separate indexes for these two classes of investments.
- *International Credit*: We are pleased to see International Credit has been separated out, but we believe a better index would be the Bloomberg Global Aggregate Credit Index as the proposed index precludes all international investment grade credit.

Notification letter

Superannuation funds which offer a Trustee Directed Product that receives a fail result are required to issue a letter to affected members. We consider the draft letter under Schedule 2A to members who have money in the failed superannuation product to be potentially misleading to members who have several products in the same superannuation fund.

For example, many members deliberately invest in a range of products, investment options or asset classes for reasons which may reflect their personal values, their attitude to risk or their plans for retirement. It is often financially or administratively advantageous for a member to have all their funds within a single superannuation fund.

Yet, the draft letter states that “You should think about moving your money to a different super product” in the first paragraph. The letter should make it clear that this different product (or investment option) may be within the same fund, thereby avoiding any confusion between the terms: “product” and “fund”.

Furthermore, as these members may have more than one product in a single superannuation fund, the transfer of this single product to another fund representing a fraction of their total balance could lead to higher costs and a poorer outcome. The member must be made aware of these possibilities.

It should also be recognised that investors in a Trustee Directed Product have made a choice. Hence, it is recommended that the letter for these products (as distinct from MySuper products) must recognise that a choice has been made by the member.

It is therefore recommended that the required letter for members with money in a failed Trustee Directed Product be revised so that it is clear that these members may wish to select another investment option (i.e., product) within the same fund.

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Naturally, we would be very happy to discuss any of our comments with you and your team as you carefully consider these matters. Please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Dr Knox', written in a cursive style.

Dr David Knox
Senior Partner