

# HESTA consultation submission

Superannuation performance test

April 2024



Super  
with  
impact

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## Introduction

Super with Impact™ is the positive outcome we create by supporting our members to face the future with confidence, being a gutsy advocate for a fair and healthy community and delivering investment excellence with impact. We use our expertise and influence to deliver strong long-term returns while accelerating our contribution to a more sustainable world.

An effective performance test is an essential safeguard to identify underperforming funds as well as help deliver strong net benefit to members as measured by net investment returns.

Since the introduction of the performance test, we believe the policy intent to identify and redress underperforming products has largely been achieved. It is, therefore, timely to strengthen the Test's objective by adding deliver strong 'net benefit' to members.

HESTA supports a principles-based approach to the design of a performance test. In doing so, we identified the key challenges and unintended consequences in the current test that may hinder achieving strong net benefit for members.

Our submission includes consideration of a performance test framework that better identifies consistently underperforming funds while introducing a stronger focus on net benefit.

HESTA would welcome the opportunity to meet with Treasury to discuss the detailed design of a future performance test.

## About HESTA

HESTA is a profit-to-member industry super fund investing more than \$83 billion on behalf of more than 1 million members. We invest in and for people who make the world better.

Around 80% of HESTA's members are women, more likely to be earning what is considered low to middle income roles in the health and community services sector including aged care and community services.

Based on our member profile in our Accumulation product as at November 2022, women earn 16% less than their male counterparts on average, are less likely to be able to save outside their super and are more likely to have lower account balances when they retire compared to their male counterparts. Many of our members spend considerable time in unpaid care work, which adds enormous economic benefit to the country at the expense of their own financial security.

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### **HESTA recommends a future performance test should:**

1. Focus on delivering strong 'net benefit' to support improved member outcomes, and
  2. Enable innovation in investment.
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### **Performance Test Design Principles**

In considering the consultation paper, HESTA's recommendations are guided by the following key design principles. The test should:

- assess the actual total net investment returns (after all investment fees and taxes)
- assess and pass products which are meeting or exceeding an appropriate investment objective (e.g. CPI+) for their risk profile, and
- where a product fails, a second metric should consider products that are persistent underperformers and against the product's competitor risk cohort.

## HESTA recommends

### Recommendation 1: Focus on 'net benefit' to support improved member outcomes

- The primary principle of 'improving member outcomes' should be defined as the delivery of strong 'net benefit' measured by net investment returns, as this is what is credited to member accounts.
- Assessing the delivery of strong performance testing could be achieved through a multi-stage test with a primary test of fund performance against a CPI+ objective for comparable portfolios (by risk cohort).
- If required, a secondary phase comparing fund performance against industry peers and by risk cohorts would be applied. These metrics should be focussed on assessing whether the product has delivered against its objective, and if not, whether it has been a consistent underperformer versus alternate product options.
- To assess these metrics, a long-term view of fund performance should be applied over multiple time horizons (to avoid point in time impacts).
- HESTA supports APRA continuing the current approach to consequences when a fund has underperformed.
- The overall effect of our proposed change would improve member outcomes by holding trustees to account for underperformance, while enabling strong long-term investment performance.

### Discussion

HESTA believes strong performing funds are those that have, consistently over time, delivered strong member outcomes through sound investment strategies and effective implementation, in line with their stated product objectives.

Funds demonstrating persistent poor investment strategies and poor implementation, leading to poor net investment outcomes, should be identified and redressed through the performance test. This should be assessed across multiple horizons, with multiple year-end dates.

HESTA recommends prioritising improving member outcomes as the core principle with strong net benefit the most appropriate metric to measure member best financial outcomes.

Strong net benefits are the key driver to growing members superannuation over time and their eventual balance at retirement. This is especially important for HESTA members as they are less likely to be able to save outside their super and who typically have lower account balances at retirement.

### *Design option - Multistage test*

In considering the proposed metrics and principles, HESTA believes a multistage outcomes-focussed test would be more effective and enduring in identifying consistently underperforming funds as well as identifying strong net member benefit.

Stage 1: The first stage compares a fund's investment option's net investment returns against an appropriate CPI+ objective. The investment option should be consistent with the CPI+ objective for investment options with similar risk cohort.

First, net investment returns, could be compared against a relevant investment objective (e.g. a CPI+ relevant to the product's risk cohort) over an appropriate time horizon (e.g. 10 years). Funds with sound investment performance (underpinned by both investment strategy and implementation) are anticipated to pass this first test. This test is designed to ensure that members are delivered appropriate risk-adjusted returns and, by using an absolute measure of success.

However, we acknowledge that there may be market and economic conditions that prevail, resulting in a large percentage of funds not meeting the CPI+ objective. In this situation, we recommend a second test which captures a level of market awareness.

Stage 2: The secondary test compares net investment performance against competitor funds in similar risk cohorts.

In this environment, a fund could be deemed as underperforming where it does not meet the primary test and the net return against peers is in the bottom decile over several time horizons.

HESTA recommends this suggested multi-stage test be assessed over multiple time horizons (i.e. multiple years and multiple year-end dates) to determine when a fund has persistently underperformed.

### **Recommendation 2: Enable innovation in investment**

- HESTA uses our expertise and influence to deliver strong long-term returns while accelerating our contribution to a more sustainable world.
- The performance test should foster innovation in investment, encouraging funds to pursue emerging asset classes that support economic growth and strong long-term returns to members.
- The performance test should not restrict funds in developing total portfolio investment strategies that seek to manage long-term systemic risks, such as climate-related financial risks and to deliver strong long-term net investment returns to members.

### *Discussion*

We recommend the performance test be designed to foster innovation by removing the constraints of over-specified benchmarks, which are not linked to member outcomes.

This change would support funds (if aligned with their strategy to deliver to members) to actively invest in emerging asset classes that support economic growth and strong long-term returns to members. It would encourage funds to pursue innovative and attractive investment opportunities; with a view to the contribution of the investment to the total portfolio risk-adjusted return; without constrained performance relative to a backward-looking benchmark. This investment innovation has proved a significant strength of the Australian superannuation market (e.g. pioneering of the infrastructure asset class) and we believe, has contributed to strong financial outcomes.

Similarly, this would support funds to manage long-term systemic risks, such as climate-related financial risks. By enabling funds to respond to

the climate transition, they will be able to continue to deliver sound long-term investment performance for members.

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## Conclusion

In addition to considering the YFYS performance test, HESTA supports one product for life, and the introduction of an evidence-based retirement product performance test. Development of this performance test will require careful analysis given funds have only recently implemented the Retirement Income Covenant and the review of the existing performance test for the accumulation phase is underway.

HESTA welcomes the opportunity for further discussion on our recommendations with Treasury and to share our modelling on the proposed performance test options in the Consultation Paper.

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