Your Future, Your Super Review
Submission by David Hartley

Executive Summary

My professional investment experience of more than 40 years includes direct responsibility for institutional investment management, along with meeting and analysing the periodic investment performance of many hundreds of investment managers and their investment products, including superannuation and similar funds. I have also engaged with various regulatory authorities and participated in workshops arranged by government agencies.

I have provided this submission purely in my personal capacity. None of the views I express should be taken as being representative of any organisation with which I have been or am currently associated.

A summary of my views is:

- The underlying goal of the YFYS performance test is noble but the test in its current form is not fit-for-purpose.

- According to any reasonable interpretation of ASIC's Regulatory Guide RG53, the YFYS test in its current form has a high risk of misleading superannuation fund members. This is not desirable.

- The YFYS test in its current form will lead to distortions in capital markets and increase systemic risk. This is not desirable.

- The YFYS test in its current form will discourage superannuation funds from investing in important nation-building assets and potential engines for economic growth. This is not desirable.

- The YFYS test in its current form will lead to a reduction in the dispersion of returns across the range of superannuation funds. This may be desirable.

- The framework ignores non-investment factors that may be important to some members, such as insurance cover. This is not desirable.

Detailed observations that led to these views, together with some suggested solutions and specific comments on questions raised by Treasury, appear in the remainder of this submission.

I would be happy to provide further information to assist Treasury, ASIC and/or APRA to refine the approach to performance assessment so that it has greater efficacy.

ASIC Guidance

In July 2003, ASIC published ***Regulatory Guide 53 The use of past performance in promotional material (RG53).***

Included in RG53 are several important principles as to what might constitute misleading conduct in relation to the quoting of investment performance. These principles also accord with my investment experience over the last four decades.

The intent of RG53 relates to actions of those who promote a product. Section 4.3 (b) states that promotion "*means any statement (including advertising) intended, or which would reasonably give the impression that it was intended, to induce a person to acquire, hold or vary a financial product or service"*. This definition appears consistent with the stated intention of Treasury to encourage superannuation fund members to switch funds from products that underperform the YFYS test.

Promotion, as defined by ASIC, also accords with statements by APRA Executive Board Member Margaret Cole in an opinion piece published in the Sydney Morning Herald on 9 November 2021. In this article entitled "Members fail to heed warning on dud super funds", Ms Cole stated that after the notification of YFYS performance test results "we have not seen as much movement of people switching to new funds as we would like". Clearly the YFYS test was intended to induce people to vary their superannuation provider.

In Section 8.3 of RG53 ASIC states that "*It may be misleading to imply that reliance on simple past performance figures would be a good way to select a financial product or service."* In further explanatory notes ASIC states that *"Promotions have a higher risk of being misleading if they focus on past performance as a sole or dominant method of selecting a financial product or service."*

This makes sense, as no-one can invest and immediately benefit from past investment returns. It is future investment returns that matter. There is a good reason why funds and managers quoting investment returns are required to state that past returns are not necessarily a good guide to the future: it's the truth.

Deliberately and explicitly, the YFYS performance test framework adopted by Treasury asserts that a narrow measure of past returns should be taken as a guide to select a superannuation fund. ASIC's RG53 states that this may be misleading. The fact that the YFYS performance test framework has the imprimatur of government may give it an even greater chance of being misleading.

In Section 11 of RG53 ASIC provides guidance for the limited situations in which it may be appropriate to quote "non-actual" performance, "*Overall, the following are the only scenarios where it is clear that non-actual performance <u>may</u> be able to be used in a non-misleading way (given appropriate presentation):*
• where a new fund is identical to an existing fund, except for different fees (eg a new retail fund will invest in an existing wholesale fund);
• where the new fund will mirror an index."

Several MySuper products changed significantly since the introduction of MySuper. Perhaps most significantly, some MySuper products moved from a single portfolio to a lifecycle approach to target the needs of different member cohorts more specifically. To calculate performance for these products APRA, under the direction of Treasury, spliced the performance of very different approaches. This led to a performance calculation that cannot, and does not, reflect the actual performance achieved by any single member.

Some other funds moved to completely outsource investment management, leading to a clear break in the performance track record. One such fund was Maritime Super, which outsourced to HostPlus.

Based on a reasonable understanding of the ASIC guidelines, the current YFYS performance test framework has a high risk of being misleading.

Furthermore, and unrelated to investment returns, for some members insurance cover will be critical. Moving from one superannuation fund to another purely based on the results of the YFYS performance test, without considering the impact on insurance cover, may be very detrimental to a member's financial situation.

The YFYS Performance Test and its Operation

The intention of the YFYS performance test, to identify and eliminate poor performance, is noble.

However, there are major flaws in the current YFYS performance test and its operation that, in combination, make it not fit-for-purpose. These include:

- The prescribed letter to be sent to members is, in effect, unlicensed investment advice from the Treasury that has no regard for individual circumstances. Contrary to ASIC Regulatory Guide 53, it also advises members of superannuation funds to consider moving their retirement savings to a "better performing product", implying that past performance should be the sole determinant to select a superannuation fund.

  In this light it is constructive to consider one of the MySuper products that failed the first YFYS performance test. Based on calculations as at 30 June 2021 Christian Super failed the YFYS test and was required to provide its members with Treasury's prescribed letter. Over the subsequent financial year to 30 June 2022, Christian Super's investment return ranked third in the SuperRatings SR50 survey[1]. The return was close to 4% above the median fund in that survey and more than 2.5% above the top quartile. This suggests that almost every member who, after receiving the prescribed Treasury advice, moved money from Christian Super to a different fund would have lost money.

- The construction of the prescribed letter could initiate a run on one or more funds, which would not be in the best financial interest of members of that fund or the economy as a whole.

  Imagine the chaos if, based on a newly introduced retrospective test, the government advised customers of one or more banks to consider moving all their deposits to another bank. Superannuation funds are a major part of the Australian economy and steps that introduce fragility into the system could be very detrimental to members, the industry, and the economy.

- Under APRA's ***Prudential Practice Guide SPG 530 – Investment Governance***, those who offer and manage superannuation products are required to determine investment objectives that reflect outcomes that are important for members. For multi-asset class portfolios, the superannuation industry often expresses such investment return objectives in the form of returns relative to inflation, to maintain purchasing power over a long-term investment horizon. Knowing that members can be panicked in times of stress, limiting the incidence and magnitude of negative annual returns might be regarded as important investment risk objectives to help overcome negative behavioural tendencies.

  The YFYS test is based purely on a relatively minor aspect of past performance, being performance relative to a benchmark designed by Treasury and applied retrospectively. It has no specific regard for member outcomes such as total return, returns relative to inflation, limiting the incidence and magnitude of negative investment returns and maintaining insurance cover.

  Performance relative to a benchmark constructed by Treasury officials would not normally be regarded as a high priority in the context of member outcomes, even if it was in existence at the start of the YFYS performance measurement period. However, the consequences of failing the YFYS test can be very negative for fund members simply because of the potential impact to cash flows. This has an inevitable impact on fiduciary responsibilities.

  Consequences flowing from failure of the YFYS performance test elevate the objective of passing the test to become paramount. Instead of being of relatively minor importance, tracking error relative to the prescribed benchmark will be the primary risk metric for most funds and will be a scarce resource that needs to be allocated carefully.

  Investment objectives more important to actual member outcomes such as total return, returns relative to inflation and the incidence and magnitude of negative investment returns, have become

[1] SuperRatings Fund Crediting Rate Survey - SR50 Balanced (60-76) Index, June 2022

subsidiary to passing the test.

- On the issue of investment risk, steps taken in times of heightened uncertainty to minimise the chance of negative investment returns, such as purchasing options or increasing holdings of cash, are assessed retrospectively under the YFYS test without regard to the potential prospective benefits that were sought and obtained from reducing investment risk.

  Such an approach is akin to assessing the purchase of insurance purely based on the amount claimed on the policy relative to the premium. Most people who take out life insurance, or fire insurance, would regard lack of a need to claim as a positive outcome even though their premium was "wasted".

  Similarly, when investment markets continue to climb higher despite periods of heightened uncertainty, a trustee taking account of the risk appetite of members may use some of the additional returns to take out insurance against market declines. This may result in positive member outcomes in terms of total return, even if the insurance does not "pay off" in the period assessed by the YFYS test and leads to a greater chance of failing the test. By discouraging such elements of caution, the YFYS test introduces a heightened degree of systemic risk across the superannuation industry.

- Drawing on my experience, I know that assessing future performance is difficult. Such assessment needs to consider carefully changes made within a product and changes in the team responsible for managing the product. This is an underlying observation that is consistent with ASIC's RG53.

  The YFYS test makes no attempt to assess likely future performance, which is particularly flawed when investment frameworks or investment teams are deliberately changed in response to past performance to generate better future performance.

  As one example, Maritime Super effectively outsourced all its investments to HostPlus, which was not identified as an underperforming fund. Members of Maritime Super would have had expectations for future returns that would be practically identical to those of HostPlus members. For the YFYS performance test, however, APRA used Maritime Super's historic results to identify Maritime Super as an underperforming fund as at 30 June 2021 with a concomitant recommendation that members consider moving to a better performing fund.

  While there may be other issues to consider, purely based on expected investment performance the advice to members of Maritime Super to seek a better performing fund seems unwarranted, as the trustee of Maritime Super had already taken significant steps to improve future performance. Under RG53 the advice to members might be regarded as misleading.

  Although it is very tempting to simply look at the performance achieved, past returns are not necessarily a guide to the future. It is important not to blindly equate good and poor results with good and poor processes. Good results might but do not necessarily reflect sound investment. Poor results might but do not necessarily reflect poor processes.

  Simple reliance on past performance is, as identified by ASIC's RG53, likely to be misleading. A more effective assessment process is multi-faceted, with past performance being only one of at least ten factors that can be used to help assess the likelihood of future investment performance. This is something that I have discussed with ASIC in the past, most recently in December 2020.

- To gain a longer performance history, APRA has spliced together performance of disparate products and performance under very different investment frameworks.

  An example of one such fund is Australian Catholic Super, which moved from a single investment option default known as Conservative Balanced to a lifecycle approach on 1 May 2018. The new LifeTime One product automatically adjusted each individual members' investments annually, on their birthday, effectively creating what might be seen as "cohorts of one".

  Despite having existed for just over 3 years as at 30 June 2021, LifeTime One was listed as an underperforming fund over 7 years and again as underperforming over the 8 years to June 2022.

This second failure of the test occurred despite the underlying four components used within the LifeTime One product ranking 7th of 48[2], 7th of 50[3], 3rd of 25[4] and 3rd of 47[5] funds in their respective SuperRatings surveys for the one year to 30 June 2022.

The previous default option, Conservative Balanced, recorded top quartile results in its SuperRatings survey[6] for the 1, 3, 5, 7 and 10 year periods to 30 June 2022.

Although the lifecycle structure makes it difficult to be definitive, it appears likely that many members who moved money from Australian Catholic Super to a different fund after receiving the prescribed Treasury advice would have experienced poorer performance over the 2021/22 financial year than that achieved by those who remained invested with Australian Catholic Super.

Despite a MySuper product being offered continuously, the structure of the product and the team responsible for the product may have changed significantly over time. In respect to the guidance provided by ASIC in RG 53, splicing of the returns in the way APRA has done, on behalf of Treasury, has a high risk of being misleading.

- The rolling nature of the test means that those funds that fail in one year are highly likely to fail in the subsequent year, irrespective of how well they perform in that year. This is because it will take a full 8-year period before performance history is completely refreshed[7].

  Again, it is instructive to consider Christian Super. Despite being one of only a handful of funds that produced a positive return in the financial year to 30 June 2022 and achieving a return that was around 4% above median, as at 30 June 2022 Christian Super's MySuper product failed the YFYS test for the second time.

  Furthermore, the SuperRatings SR50 survey reveals that, as at 30 June 2022, Christian Super's MySuper product ranked 3rd of 50 funds over three years, 14th of 50 funds over 5 years and 23rd of 48 funds over 7 years. Clearly, all these results were above median.

  Neither the test result nor the historic results achieved by Christian Super as at 30 June 2022 provide reliable guidance for future returns. Nevertheless, such competitive past performance reflects positive member outcomes.

  The fact that the fund still failed the YFYS test for a second time reflects more negatively on the efficacy of the test than it does on Christian Super's delivery of performance for its members.

The goal to identify and eliminate poor performance is noble. However, the current YFYS test and, more particularly, the prescribed advice that is required to be sent to members based on a single narrow calculation of investment performance, is not fit-for-purpose. It also appears to be inconsistent with long-standing and valid guidance from ASIC. I would be happy to provide further information to assist Treasury, ASIC and/or APRA to refine the approach to performance assessment so that it has greater efficacy.

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[2] SuperRatings Fund Crediting Rate Survey - SR50 Growth (77-90) Index, June 2022
[3] SuperRatings Fund Crediting Rate Survey - SR50 Balanced (60-76) Index, June 2022
[4] SuperRatings Fund Crediting Rate Survey – SR25 Conservative Balanced (41-59) Index, June 2022
[5] SuperRatings Fund Crediting Rate Survey – SR25 Capital Stable (20-40) Index, June 2022
[6] SuperRatings Fund Crediting Rate Survey – SR25 Conservative Balanced (41-59) Index, June 2022

[7] As an analogy, imagine legislation was passed to define a new "Your Revenue, Your Expenditure" test that Treasury would fail if the average annual budget deficit was worse than 0.5% pa of GDP over the 7 years to 30 June 2021 and then would fail again if it was still worse than 0.5% pa of GDP over the 8 years to 30 June 2022. If the test was failed in the first of these two periods it is highly likely to be failed in the second of these two periods simply because much of the data is the same, irrespective of the result achieved in the year to June 2022.

Broader Implications for the Australian Economy

In my two submissions to the ***Productivity Commission's inquiry into Superannuation Competitiveness and Efficiency*** I made several observations, recommendations, and predictions.

In my initial submission of 20 April 2016, I identified some important issues and made several recommendations. I also stated that:

"If this approach is not implemented then the most likely outcome is that investment programs will increasingly become more and more concentrated in a narrow range of strategies, such as passive investment in a narrow range of listed shares and loans. ***Other investment opportunities that could enhance the broader economy will remain starved of capital****."*

In my second submission, on 9 September 2016, I referred to the concept of a simple reference portfolio, such as that mandated in the Your Future Your Super (YFYS) regulations. I stated:

"Superficially it is attractive to adopt a standard simple reference portfolio as a benchmark against which to compare investment returns…there is a danger that any such reference portfolio will become the default investment strategy for the entire industry…Funds…will be discouraged from looking outside the reference portfolio… the overall effect that will emerge will represent a ***serious institutionalised systemic risk for the superannuation system as well as the whole economy.****"*

As was the case in my first submission, I identified solutions.

In an article published by the Investment Innovation Institute on 18 December 2019 I referred to several positive features of regulatory change, including the design and distribution obligations:

"An excellent move by the regulators is to direct funds to concentrate on outcomes that are important for the members of their funds and, in so doing, become less peer-driven. The new Design and Distribution requirements emphasise this more."

I also pointed out several positive aspects of the APRA Heatmap, but in relation to member outcomes I warned that the Heatmap had "the potential to undo some of the good work that has been done in this area." I observed that:

"The whole industry risks being invested in a "crowded trade" chosen by the regulator. ***At the same time potential future growth engines for the economy will be starved of capital****."*

Now we have a new YFYS performance test designed by Treasury that uses a narrow definition of past performance as a guide to future performance.

No one can deny the worthy intentions of a performance test that is used in the correct way.

However, one of the negative outcomes of this particular test will be to discourage superannuation funds from pursuing the innovative investments that may be necessary to help Australian superannuation fund members and the Australian economy to navigate the difficult times ahead.

For example, private capital including private equity, venture capital and social housing projects are not explicitly benchmarked and, by implication, are not considered sensible long-term investments for superannuation funds.

At the same time the Treasury encourages investments into those areas that **are** represented in the mandated benchmarks. Ironically, through the choice of benchmark, one of these is investment into Chinese companies.

A decision not to invest into China will have significant impacts on tracking error relative to the prescribed benchmarks. For example, analysis from a Hong Kong based manager indicates that the simple decision to exclude China from an international equities portfolio will introduce tracking error of around 100 basis points, which could lead to performance that is more than 1% different to that of the benchmark in around 1 year in every 3.

As a result, the YFYS performance test and its prescribed letter reflect a policy that, when the implications are understood fully, discourages investments into areas such as Australian private capital and will lead to more investments into Chinese companies. This may result in a higher investment return over some periods of time, or it might not. This is an inherent feature of investing.

The same can be said for investment options that target ESG outcomes for members and any other deliberate biases designed to have a better chance of delivering specific member outcomes.

While the impact on investment returns is uncertain, we can be certain that the current YFYS performance test and its prescribed letter will lead to a lower level of diversification within the superannuation industry as well as higher systemic risk. It will also reduce the potential economic benefit that the Australian economy could derive from its strong pool of superannuation capital.

The remainder of this submission provides specific responses to the issues raised by Treasury in the Consultation Paper.

Specific Responses to Issues Raised by Treasury

Performance test

Consultation questions

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

   Yes. The YFYS test is based purely on a relatively minor aspect of past performance, being performance relative to a benchmark designed by Treasury and applied retrospectively. It has no specific regard for important member outcomes.

   Performance relative to a benchmark constructed by Treasury officials would not normally be regarded as a high priority in the context of member outcomes, even if it was in existence at the start of the YFYS performance measurement period. However, the consequences of failing the YFYS test can be very negative for fund members simply because of the potential impact to cash flows. This has an inevitable impact on fiduciary responsibilities. It elevates the objective of passing the test to become paramount, instead of being of relatively minor importance.

   The measurement process means that funds will use tracking error relative to the YFYS benchmark as a primary risk metric. Dynamic asset allocation will be less likely to take place while more frequent changes to strategic asset allocations can be expected if trustees decide to make changes to increase or increase overall risk.

   Protection strategies such as the purchase of options to hedge downside risk will be less likely to be used.

   At the asset sector level, irrespective of the investment view of relative risk and return there will be less willingness to exclude assets that are in the benchmarks and less willingness to include assets that are not well-represented by the specified indices.

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. Equity risk dominates the overall investment risk in most superannuation funds and many trustees have been keen to find assets that diversify this risk. The current set of indices for the YFYS test does not cater well for assets, such as hedge funds, that deliberately seek to add exposures that are market neutral. For such assets the market beta being sought is more akin to cash although clearly the objective would be to achieve a return that exceeds that of cash.

   Using public equity benchmarks to benchmark private equity inevitably invokes tracking error. For some other assets that are not publicly traded, such as infrastructure and property, the benchmarks prescribed are uninvestible and therefore will also lead to tracking error. Investment in areas such as social housing projects would be another source of tracking error.

   Given that the YFYS performance test framework makes tracking error a metric that needs to be carefully calibrated and managed, the natural response that can be expected is that trustees will limit overall exposure to all unlisted asset classes; irrespective of whether they are seen as a sensible investment that can help deliver desirable member outcomes.

   As a corollary, the YFYS test in its current form will limit the willingness and ability of funds to participate in nation-building or socially targeted programs.

Furthermore, those trustees who wish to exclude investments on Environmental, Social or Governance (ESG) grounds need to take a tracking error risk that may be unacceptable in a YFYS regime, which will lead to a reduction in choice for members.

There is not an easy way to adjust benchmark indices to cater for this impact, partly because so much of the investible set of assets for superannuation funds is not represented in standard indices and some of the prescribed indices include assets that are not investible.

it is difficult to predict what assets or classes of assets will emerge over time. Some of these might provide a superior method for trustees to meet important member outcomes but any asset class that is "new" will not be included in the YFYS benchmarks; including it in portfolios will inevitably increase tracking error.

Despite these shortcomings, the benchmark indices currently prescribed might not be able to be improved. The consequences of failing the test upon which they are based present the main practical problem.

The real efficacy of the test lies in the questions that it raises for further inquiry as opposed to the narrow aspect of performance that it measures. If the consequences of the test were not so dire and, more simply, led to dialogue and further analysis by APRA across a broader range of factors than simple past performance, this would give better recognition that the benchmarks and the test are not perfect and should be viewed in a broader context.

I would be happy to provide further information to assist Treasury, ASIC and/or APRA to refine the approach to performance assessment so that it has greater efficacy.

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?**

Yes. The test is clearly directed to investment returns and takes no account of other member outcomes that a member may believe is important. The main way for this to be addressed is for the communication of results to members to give greater weight to factors other than past performance.

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?**

If this YFYS test continues in its current form, the most likely outcome is that investment programs will increasingly become more and more concentrated in a narrow range of strategies, such as passive investment in a narrow range of listed shares and loans. Dispersion in returns will decrease and ultimately all funds will construct their investment strategies in a way that virtually guarantees that the test will be passed.

Money will flow naïvely into strategies represented by the benchmarks as selected by Treasury and the short to medium term performance of such naïve strategies will be very strong. Funds that choose not to invest in this way will suffer in terms of performance. As a bubble inflates trustees will be discouraged from looking for other assets. In time, assets represented by the Treasury benchmarks will become highly priced relative to other assets but there will be no incentive to seek the better-value assets. The overall effect that will emerge will represent a serious institutionalised systemic risk for the superannuation system as well as the whole economy.

At the same time, other investment opportunities that could enhance the broader economy will remain starved of capital.

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?**

Yes. There is evidence that the notification and website publication requirements have led to member switching.

Whether this can be "improved" depends on the intent of a process that can be regarded as unlicensed investment advice. Is an "improvement" simply viewed as an outcome in which more members switch? Alternatively, and in my view more appropriately, is it one in which those members who do switch have not been misled?

In this light it is constructive to consider one of the MySuper products that failed the first YFYS performance test. Based on calculations as at 30 June 2021 Christian Super failed the YFYS test and was required to provide its members with Treasury's investment advice.

Over the subsequent financial year to 30 June 2022, Christian Super's investment return ranked third in the SuperRatings SR50 Balanced survey. The return, one of a small number in the industry that was positive, was close to 4% above the median fund in that survey and more than 2.5% above the top quartile. This suggests that almost every member who acted on the prescribed Treasury advice would have lost money in both relative and absolute terms.

To many, this would be seen as a negative outcome notwithstanding the fact that Christian Super's MySuper product failed the YFYS test for the second time as at 30 June 2022, supporting a view that the current YFYS performance test, coupled with the prescribed communication, is not guaranteed to improve member outcomes.

This is consistent with guidance provided by ASIC in its Regulatory Guide RG53 on the use of past performance in promotional material. RG53 indicates that recommendations to switch funds based purely on past performance may be misleading.

The main way for this to be improved is for the communication of results to members to give greater weight to factors other than simple reliance on past performance. Furthermore, if the consequences of the test were not so dire and, more simply, led to dialogue and further analysis by APRA across a broader range of factors than simple past performance, this would give better recognition that the benchmarks and the test are not perfect and should be viewed in a broader context.

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?**

The simplest way in which some funds have been able to turn a "fail" into a "pass" has been to reduce fees, as this change has an immediate effect on the YFYS performance metric regardless of the level of fees that has been applied historically.

Improving investment performance is more challenging. The rolling and retrospective nature of the test means that those funds that fail in one year are highly likely to fail in the subsequent year, irrespective of how well they perform in that year. This is because it will take a full 8-year period before performance history is completely refreshed.

Again, it is instructive to consider Christian Super. Despite being one of only a handful of funds that produced a positive return in the financial year to 30 June 2022 and achieving a return that was around 4% above median, as at 30 June 2022 Christian Super's MySuper product failed the YFYS test for the second time. Christian Super's results as at 30 June 2022 were also above the SuperRatings SR50 median for the 3, 5 and 7 year periods. What else could Christian Super have done to "improve" performance?

Given this retrospective feature of the test, the clearest path and the one most taken by trustees of funds that fail the test has been to seek to merge.

However, the operation of the test is such that even when funds have agreed to merge, the fund that failed the test in one year is likely to fail a second time. Requiring that fund to again write to its members is somewhat redundant, as the transferring fund has already taken members' best interests into account and is in the process of staging an orderly transition on behalf of all members.

Successor fund transfer (SFT) processes are complex and require several notifications to members. If members are, at the same time, receiving communications prescribed by Treasury then they will have a high chance of becoming confused.

In addition, members leaving the transferring fund prior to the scheduled transition will lead to a reduction in the net benefits that the receiving fund will expect for its own members. In response, the trustee of the receiving fund might form a view that proceeding with the merger is not in its own members' best financial interest. This may then result in a very bad outcome for members of the fund that is seeking to merge into a "better performing fund".

A sensible improvement to the YFYS framework would be to exempt transferring funds from the test as at the end of a financial year, providing that a SFT is scheduled to be completed within the subsequent year.

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?**

Yes. The performance test defines performance in narrow terms that, over time, will lead to a precise and narrow implementation. After a full 8 years under the YFYS framework, very few funds will be classed as "underperforming" irrespective of whether outcomes for members are good or bad.

The main impact of the measures will be to reduce dispersion in the returns across different MySuper products. Treasury might regard this as a desirable outcome in its own right that will, over time, lead to MySuper members getting similar returns irrespective of the fund of which they are a member.

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

One could argue that the broad set of members who are in MySuper products would be served reasonably well by a framework that reduces dispersion in returns. In contrast, idiosyncratic member preferences might require more targeted investment options. Funds who see this as a market niche they want to fill will build a range of options that can be combined to target a "cohort of one".

TDPs may provide members with a wide range of options, including portfolios that display positive ESG credentials or portfolios that include significant private market exposure. The benchmarks used

under the existing YFYS framework will not cater well with such portfolios due to inherently high tacking error.

More generally, it makes little sense to impose the YFYS performance test framework on products that are specifically chosen by members.

The test in its current form should not be extended to TDPs.

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?**

Choice products may provide members with a wide range of options, including portfolios that display positive ESG credentials or portfolios that include significant private market exposure. The benchmarks used under the existing YFYS framework will not cater well with such portfolios due to inherently high tacking error.

The test in its current form should not be extended to Choice products.

Retirement products similarly may target specific member outcomes, such as the generation of sustainable income in retirement, that are not suited to the existing YFYS framework. For example, one strategy to focus on retirement income may involve a bias towards shares that pay dividends or the writing of call options over shares that are held in the portfolio, both of which will lead to significant tracking error relative to the YFYS benchmark indices.

The test in its current form should not be extended to Retirement products.

YourSuper comparison tool

Consultation questions

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?
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?
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?

I have no specific comments to make on the YourSuper comparison tool other than that its emphasis on past performance might mean that it is misleading and that its extension to Choice products will lead to an explosion of information. This latter point is particularly important when different Choice products will have very different objectives and strategies.

In this respect I also note that the ATO disclaimer, accessed on 11 October 2022 from the ATO website and reproduced below, makes no reference to past performance not being a reliable guide to future performance.

> Disclaimer
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> Data is sourced from the Australian Prudential Regulation Authority (APRA). The information on this tool is general information only. It should not be taken as constituting professional advice from the Australian Taxation Office (ATO) - or as a substitute for professional advice. The tool does not take into account your financial situation or retirement objectives. The ATO is not liable for any loss caused, from the use of, or reliance on, the information provided directly or indirectly, by use of this website

Stapling

Consultation Questions

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?
14. Are there any barriers in the current framework to achieve the intent of the stapling reform?
15. What is the actual, or likely, impact of stapling on insurance coverage?

I have no specific comments to make on Stapling other than to note that I believe it to be a useful reform. I agree that the implications for insurance may be problematic so that, on a change in employment, employees should be encouraged to consider the employer's nominated default fund that may be better targeted to the specific industry in which the employer operates.

Best financial interests duty

Consultation questions

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

I have no specific comments to make on Best Financial Interests duty other than to note that the intention should be only to identify the most egregious abuses.

I disagree in principle with the concept of reverse onus of proof, which is contrary to long-established legal principles. I also expect that reverse onus of proof will increase the incidence, cost and complexity of legal defence and will increase insurance costs. This will not improve member outcomes.

If reverse onus of proof is retained, then there should certainly be a materiality threshold. It makes no sense for example to go to the expense of having to document why the purchase of a paper clip does not breach the best financial interest duty.