18 March 2020

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee

Submission to the Senate Standing Committees on Economics Inquiry: *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*

Rest is pleased to provide this submission in response to the Committee's inquiry into the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*.

The Your Future, Your Super reforms

Your Future, Your Super proposes significant changes to the superannuation system with regards to the management of default contributions, performance measurement and transparency. Rest is supportive of the intent of these reforms, and improving member outcomes through lower fees, high performance and transparency. We agree that persistently poor-performing funds should be removed from the superannuation system.

Concerns about the legislation achieving the outcomes

We believe that the legislation as drafted will not achieve the outcomes outlined above and will have serious unintended impacts if not amended prior to implementation. These include:

1. Not including administration fees in the performance test will be detrimental to the intent of ensuring that superannuation is well-managed and cost effective, by not accurately representing outcomes for members.
2. If modifications to the investment benchmark metrics are not made, implementing an ineffective test will have significant impacts on funds that are wrongly identified as "good" or "bad", and will fundamentally change the way investments are managed in superannuation.

Recommendations

Rest recommends a number of amendments to the managing underperformance measure to ensure good outcomes for superannuation members, and to avoid potential undesirable outcomes. Those amendments are:

1. Include the impact of *administration fees* in the performance benchmark
2. Modify the benchmark calculations:
    a. Use more appropriate benchmarking for unlisted assets
    b. Consider a multiple tests approach rather than single measure
    c. Extend of the investment horizon

Attached is further detail on these matters and the rationale and supporting evidence. I invite you to contact me directly.

Yours sincerely,

[redacted]

Vicki Doyle
Chief Executive Officer, Rest

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About Rest

Established in 1988, Rest is among the largest of Australia's superannuation funds by membership. We use our size and expertise to deliver long-term investment performance to around 1.8 million members.

For more than 30 years, Rest has been looking after hardworking Australians and their super. Around 60 per cent of our members are women, half our members are younger than 30 years old, and many members work in part-time and casual jobs, meaning they typically have a lower average account balance.

That's why ensuring we protect members' savings is core to our investment philosophy, and why low fees are imperative. To achieve our mission, we are committed to delivering strong, long-term investment returns, low fees, flexible and affordable insurance, and leading digital customer service and advice to help members engage with their retirement savings.

Rest has long supported policy and initiatives to reduce the number of unnecessary multiple accounts in the interests of maximising member outcomes. We are also strong advocates of transparency to members, and the provision of information that allows members to make informed decisions about their superannuation.

Recommendations on managing underperformance

Rest supports the objective of ensuring that only high-performing funds are permitted to manage superannuation for Australians. We agree with the intent of the proposals to establish expectations for superannuation fund performance, and consequences for funds that persistently do not meet them.

However, the legislation in its current form also represents a considerable change to the established management of investment performance, which has been a required standard since the commencement of MySuper. These changes would effectively apply retrospective consequences to investment decisions made by funds in the existing policy and regulatory environment. We do not believe this is reasonable or in the best interests of members. We believe our suggested alternatives will provide better outcomes for members.

Rest recommends the following amendments to the performance benchmark in order to ensure good outcomes for members:

1. **Include the impact of administration fees in the performance benchmark**

2. **Modify the benchmark calculations:**

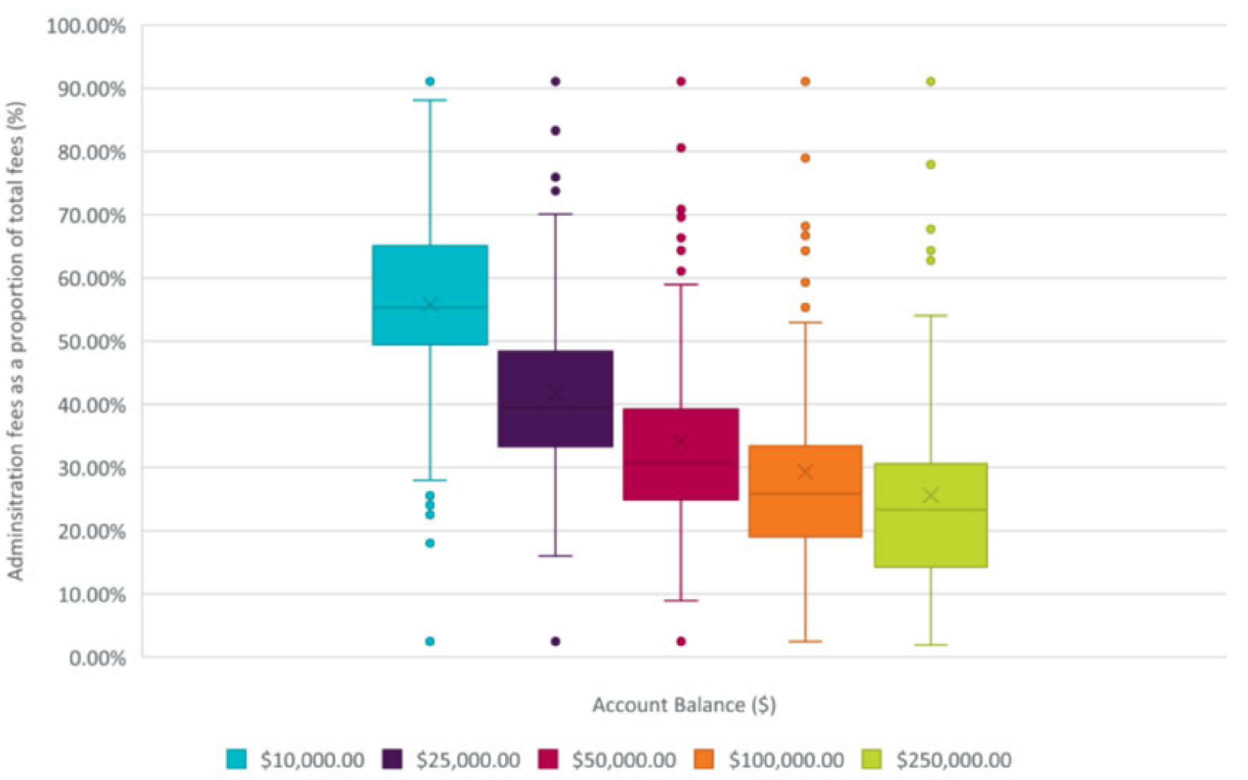
    a. **Use more appropriate benchmarking for unlisted assets**
    b. **Consider a multiple tests approach rather than single measure**
    c. **Extend the investment horizon**

1. Including administration fees

The current proposed benchmark is based on investment returns net of *investment fees* only. This does not reflect the full impact of fees on member outcomes. For this benchmark to truly drive improvements in retirement outcomes, it must also measure the impact of *administration fees* on overall net financial outcomes. Only then will the benchmark measure the holistic performance of a superannuation fund.

Analysis conducted by Rice Warner[1] shows that administration fees can make up as much as 90 per cent of a member's total fees. This can have a significant impact, particularly for younger people and those with lower account balances, who are less likely to engage with their super and make choices about their fund or investments.

Figure 1: Administration fees as a proportion of total fees by account balance



When a **member has an account balance of $10,000, the administration fees will comprise at least 50 per cent of all fees charged in around three quarters of all MySuper products.** For half of all MySuper products they comprise the majority of all fees, sometimes as high as 80 or 90 per cent.

When this account balance increases to $100,000, administration fees can still comprise up to 30 per cent of total fees in the majority of MySuper products. Even for members with $250,000, the administration fees charged in about one quarter of all MySuper products comprise more than 30 per cent of total fees.

Therefore, a fund with higher administration fees and lower investment fees may appear to be a strong performer when measured by returns net of investment fees alone. But when total fees are included, their results could be significantly beneath the benchmark.

This difference in the administration fees charged can have a significant impact on retirement balances.

If you compare two members with balances of $10,000, the member with a low investment fee and low administration fee could be up to $78,000 better off in retirement compared to a member with the same investment fee and a high administration fee.

This is equivalent to an approximately 11 per cent difference in retirement balance.

Importantly, this same research shows that administration fees vary widely between funds regardless of the investment fees charged, worsening the distortion and impact of excluding administration fees. Performance benchmarking using investment fees only may therefore provide members with a skewed impression of the net benefit they are receiving from their fund.

Rest understands there **are millions of accounts in the superannuation system with balances of less than $10,000**, particularly after withdrawals under the Early Release of Superannuation measure in 2020. This **means that disregarding the impact of administration fees** [redacted] **is likely to a significant proportion of Australians** who hold a superannuation account.

Rest recommends the inclusion of administration fees because measuring performance net of total fees more accurately demonstrates how a fund is delivering retirement outcomes for members and is a much more appropriate basis of comparison.

Furthermore, to provide information to fund members based on only one aspect of their net returns, while then providing different metrics in the ATO YourSuper online comparison tool, is misleading and confusing. This will complicate the objective of providing clear and transparent information about a person's superannuation position.

We acknowledge that measurement including total fees has limitations, due to fixed-dollar and percentage-based fee structures making it complex to aggregate on a whole-membership basis. However, we note that APRA has previously determined sample balances for fee comparison purposes that could be appropriate in this context.

An alternative to the above approach would be to consider a fund's administration fee in the event that a fund fails the annual performance benchmark review, assessed by APRA, prior to the application of any consequential actions. This could determine if a fund's returns represent genuine underperformance and limit instances where well-performing funds are incorrectly identified by the test.

2. Modifications to enhance the efficacy of the performance benchmark

To ensure that the performance benchmark test reflects the balanced portfolio that exist in funds that actively manage to a Strategic Asset Allocation (SAA) process, it is important that the benchmark applies an appropriate test.

The current proposed test has two major shortcomings:

- **First,** there is an unacceptably high likelihood that well-performing funds could fail the test, while poor-performing funds could pass.

- **Second,** the test will encourage funds to change the focus their investment strategy to shorter-term horizons. This would likely lead to a shift away from long-term investments is unlisted assets, such as nation-building infrastructure, agriculture and direct property in Australia. These assets have delivered strong returns and investment diversification to millions of Australians, who would not be able to access these investments on their own.

To this end, we strongly recommend consideration of:

- the inclusion of appropriate benchmarking of unlisted assets;
- the inclusion of a multiple-tests approach; and
- An extension of the investment-horizon test to at least 10 years.

(a) Appropriate benchmarking of unlisted assets

The proposed test benchmarks unlisted assets against a listed index, which is not a reasonable comparison. Unlisted assets are quite challenging to benchmark, as the performance of these asset classes may differ from a listed index equivalent by up to 15 per cent, per annum over quite extended periods. Performance cycles can also be significantly longer; the difference in performance of unlisted assets compared to listed assets in the same class, can occur over extended time frames.

Alternatives to the currently proposed listed index are:

- Australian and overseas private equity: the Cambridge Associates indices
- Listed infrastructure: a measure of CPI+ five per cent, due to the limited availability of indices
- Unlisted Australian property: the MCSI / Mercer Australian Wholesale Pooled Property Fund Index
- Unlisted international property: the NCREIF ODCE Index Hedged

(b) Including a multiple-tests approach

We consider that a well-designed collection of metrics will be more effective than a single metric. The ‘single, simple’ test is too simplistic to provide an effective measure of performance, given the serious consequences of not meeting the proposed test. The problem of legislating a single point-in-time test is:

- A very large proportion of the industry may ‘fail’ the test at the same time in the event of a single adverse occurrence (for example, a sharp drop in the value of the Australian Dollar, or a rise in interest rates).
- The test strongly discourages funds from adopting active risk management strategies **within** asset classes.

There is a range of solutions that could involve multiple investment performance, for example, a CPI+ objective, SAA peer group comparison, simplified reference portfolio and SAA benchmark portfolio. Fee comparisons could also be included. For consumers, this would still lead to a single result, but would provide a measure more reflective of the variation in investment approaches across the superannuation industry.

(c) Extending the investment horizon

Many superannuation funds establish SAA processes that look to a 10-year investment horizon. In fact, **the MySuper dashboard requires funds to set investment objectives on a 10-year timeframe**. Given the long-term nature of superannuation investment, and that funds are looking to preserve and build capital for members over a 40-to-50-year period, a longer horizon is more reflective of the strategies established by funds.

In addition, we have concerns about the 0.50 per cent threshold for ‘failure’ against the benchmark within the eight-year horizon. The combination of an eight-year horizon and 0.50 per cent threshold combine to make the test a very poor indicator of long-term performance.

An analysis of the currently proposed test by a working group of leading investment and actuarial consultants found that it was likely to be "highly unreliable" and ineffective at identifying poorly performing funds over an eight-year timeframe.[2]

In fact, the analysis found that the test was about as effective as a coin toss at correctly identifying performance. It had around a 50 per cent likelihood of mis-identifying poor performers as good performers, and a similar likelihood of mis-identifying well-performing funds as poor performers.

The lack of effectiveness in the currently designed test, coupled with the long-term nature of superannuation investments and the benefits this delivers to members, mean that the test should assess performance over longer timeframes. Ten-year performance is the minimum timeframe that should be adopted.

Rest supports the intent of having a performance measure to protect members from underperforming funds. But, without changes, the outcomes will not achieve the Government's objectives and will fundamentally change the way funds invest. This would be to the detriment of the best financial interests of Australian superannuation investors and the broader Australian economy.

Endnotes

[1] Analysis conducted by Rice Warner, available on request, is on administration fees as a proportion of the total fees for all MySuper products in the *APRA MySuper Product Heatmap – Fees and Costs*

[2] David Bell, Emily Barlow, Andrew Boal, Kim Bowater, Nick Callil, David Carruthers, Matthew Griffith, Clayton Sills and Tim Unger, *Working Version: Review of the Your Future Your Super Performance Test Detailed Paper*, 20 November 2020, https://www.ricewarner.com/wp-content/uploads/2021/02/YFYS-Detailed-Paper-20201127.pdf