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## Performance Test Treatment of Faith-based Products - Regulations

Industry Super Australia (**ISA**) is a collective body for funds that carry the Industry SuperFund symbol. ISA manages research, advocacy and collective projects on behalf of those funds and their five million members. Our aim is to maximise the retirement savings of all our members.

We welcome the opportunity to comment on the draft regulations supporting the proposed primary legislation on the treatment of faith-based superannuation products under the performance test.

As set out in our submission to Treasury in respect of the draft legislation, ISA strongly supports the policy intention of the performance test, which aims to increase transparency and protect members from underperforming products, by holding trustees accountable for the investment performance they deliver to members and encouraging trustees to reduce fees.

Robust performance testing of all APRA regulated products is an important consumer protection measure. This has been ISA's consistent position and was most recently advanced through consultations in relation to the Your Future, Your Super reforms.

In this context, ISA considers that performance tests should be applied consistently to all superannuation products covered by the legislation. As described further below:

- ▶ it is not clear why it is necessary to introduce a differential test which undermines the intention of the performance test regime by permitting a class of superannuation products to underperform compared with the rest of the market;
- ▶ there may be significant difficulties in creating appropriate indices for the purpose of the differential test; and
- ▶ the regulations do not provide sufficient protections for members of funds with faith-based products that are eligible for the supplementary test.

## Policy Rationale

The Explanatory Memorandum for the proposed legislation and the Explanatory Statement for the associated regulations do not provide a policy rationale for the introduction of a supplementary performance test. It appears that the rationale is to allow consumers to choose to invest in superannuation products that align with their values notwithstanding these products may not perform as well as other products.

ISA supports a superannuation system that gives effect to the social policy objectives that underpin it. A diversified superannuation market that provides Australians with the opportunity to choose how their money is invested helps to realise these policy objectives. However, in a compulsory system with low levels of member engagement and financial literacy, member choice must be limited to products that are high quality and which can reasonably be expected to provide levels of long-term performance, consistent with the social policy objectives of the system.

Further, it is not clear how many funds (or members) would be affected by the proposed legislation. ISA is not aware of any ongoing MySuper products that are faith-based products nor are we aware of how many trustees may wish to apply for faith-based status. It is also unclear how many of those potential applicants would be unable to meet the standard performance test because of their faith-based investment strategy.

In the circumstances, we do not consider there is sufficient justification for the creation of a differential test which both undermines the intention of the performance test regime and is inconsistent with the social policy underlying the superannuation system.

## Indices

The draft regulations provide that for the purposes of conducting a supplementary performance test for a faith-based product, APRA may make a determination specifying alternative assumed indices for the covered asset classes in the table in regulation 9AB.17 of the Superannuation Industry (Supervision) Regulations 1994 (**principal regulations**). ISA anticipates that APRA may have significant difficulty in determining appropriate alternative indices for faith-based funds given that:

- ▶ the values held by faith-based funds will be widely variable depending on the relevant faith or even among different funds within that faith; and
- ▶ the exclusions from a faith-based fund's investment portfolio may be specific (i.e., particular companies rather than more broad asset classes). By contrast, other values-based products (e.g., socially responsible products) will generally have consistent exclusions of asset classes.

While the draft regulations require APRA to consider the suitability of any indices provided in the trustee's application for faith-based status, this may result in the adoption of indices that are only relevant to particular funds or a small sub-set of funds. This approach undermines the intention of the performance test to assess trustees against objective performance benchmarks.

In addition, the draft regulations do not indicate whether the determination made by APRA must be published. ISA considers that any alternative index or indices used to assess the

performance of the relevant faith-based product should be publicly available to ensure transparency and for consistency with the publication of the existing indices at 9AB.17 of the principal regulations.

### Consumer Protection

If a product fails the annual performance test, the trustee of the product has 28 days to notify affected product holders and to direct them to the YourSuper comparison tool to consider switching to a different product. A list of underperforming products is also published by APRA on its website each year. Making this information publicly available promotes accountability, by encouraging trustees to improve their performance; and transparency, by providing members with information about their fund's underperformance so that they can make an informed choice as to whether to switch to a better performing product.

However, where a faith-based product has failed the annual performance test, these consequences will not apply. Instead, APRA must assess the product against the supplementary performance test. The trustee only experiences the consequences of a failed performance test if it fails the supplementary performance test. As a result, members of the faith-based product may not be aware that the superannuation product in which they are invested has failed the annual performance test and is therefore underperforming when compared with other superannuation products. ISA recommends that for the purposes of consumer protection, members should be made aware that the faith-based product has failed the performance test but has passed a supplementary test which considers the trustee's faith-based investment strategy.

### YFYS Review

ISA is currently considering its response to the Your Future, Your Super Review with submissions due on 14 October 2022. The consultation paper for the review notes that the test is intended to "improve performance and accountability of funds by using clear and objective benchmarks" and "would ensure that trustees are assessed on an objective basis, beyond how they choose their own methods of performance comparison". In the context of this policy rationale, Treasury is considering the performance testing regime, including whether there are likely to be any implementation issues or unintended consequences as the test is extended to other (non MySuper) products. As such, ISA proposes that the application of the performance regime to faith-based products should be considered as part of this broader review as the outcome of the review may have significant implications for all values-based products, including faith-based products.

Please do not hesitate to contact me, should you have any further questions regarding this submission.

Yours sincerely,



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