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Annual Superannuation Performance Test – design options

About the Super Members Council

We are the collective voice for more than 11 million Australians who have over $1.5 trillion in retirement savings managed by profit-to-member superannuation funds. Our purpose is to protect and advance the interests of super fund members throughout their lives, advocating on their behalf to ensure superannuation policy is stable, effective, and equitable. We produce rigorous research and analysis and work with Parliamentarians and policy makers across the full breadth of Parliament.

Super Members Council (SMC) thanks Treasury for the opportunity to contribute evidence and analysis on how Australia can continue to enhance the annual superannuation performance test.

This submission analyses how the current test is operating and highlights areas for potential further enhancement, informed by both policy principle and a high-quality rigorous evidence base.

Executive Summary

Key recommendations

- The existing super performance test benefits consumers – and should continue to operate.
- The existing test should be strengthened now, with simple improvements, as outlined in this submission.
- More investigation is needed of broader, structural, and longer-term options proposed in the Treasury consultation paper, and by SMC in this submission.
- Consistent principles should always be used when making changes to the test, to give clarity to investors and ensure the test continues to benefit superannuants long term.

Driving better returns for members

The YFYS performance test (the test) has applied since 1 July 2021 for MySuper products. Fine-tuning adjustments made in 2023 mean the test in its current form has only existed for one testing year.

SMC supports the continued use of the test given its clear and crucial role in driving better returns for super fund members.

Coupled with APRA's heatmaps, the test has improved member outcomes by making super funds more accountable for their performance and driving a sharper focus on stronger returns.

The test has specifically delivered stronger results for members in MySuper products including:

- underperforming MySuper products have either exited the market or improved their performance
- many members in poor performing MySuper products are now in better performing products, and
- total fees have been reduced for 80 percent of MySuper products resulting in fee savings of almost $1 billion in 2022-23.
- trustees have added cumulative value of around $18 billion to members' accounts in excess of the benchmark yardsticks set.

This is hugely significant, as over 12 million Australians have their super in default MySuper products.

The test has also generated useful insights into systemic trends and issues. For example, it shows MySuper products in the profit-to-member sector consistently outperform those in the retail sector, continuing to shine a light on structural issues that can and should be addressed.

Overall, these are positive results that hold funds to account for the quality of the products and options they provide.

And while the positive impact of the test has been demonstrated for default MySuper products, the impact on choice members is still unfolding, with the test only extended to Trustee Directed Products on 1 July 2023.

Consecutive failures of these products and resultant product closures will not be revealed until August 2024, while a range of other products and options continue to remain absent from the testing regime.

An opportunity to improve the test now

There are several simple improvements that could be made to the test now, to improve its effectiveness.

These changes would strengthen the original design intention, while continuing to give the certainty and stability to investors and should be the focus in the short-term.

Multiple options to refine the existing test have arisen in past consultations and many of them can be progressed with minimal impact on fund investment strategies and little need for major legislative and regulatory change.

Recommended short-term improvements:

- Strengthen the consequences of failing the performance test. This would further focus funds on performance (see page 9).
- Make super funds with failed products responsible for transferring members out of these products into well performing products. An automatic mechanism for members to leave underperforming products that fail the test should be created (see page 9)
- Incorporate a single administration fee benchmark into the performance test and assess administration fees over a ten-year period – the same time span used to assess investment fees. This rewards long -term improvements in administration fees and treats investment fees in a consistent manner (see page 16).
- Extend the YourSuper comparison tool to other accumulation products, with comparisons provided for each type of superannuation product with similar risk characteristics. (see page 18).

Other medium-term opportunities to improve the test

Treasury has outlined several options for improving the test in the consultation paper. SMC believes these are longer-term in nature and need more investigation to understand the pros and cons of each.

Broader structural changes to the test, particularly to the test methodology, is a longer-term project that should only be done with careful assessment, particularly on the impact on the existing framework and investors. Significant changes to the test applied on a historic basis, for example, should not result in unintended consequences.

Separate to the long-term ideas outlined in Treasury's consultation paper, SMC believes further investigation is also warranted on the following issues.

Recommended medium-term investigations

- Further consideration of the broader set of factors that contribute to net return outcomes for members including the quality of the strategy and management of risks and how they can be better captured in the test (see page 14)
- Investigate the way in which test data is collected to ensure fees and charges paid by members are consistently reported regardless of how products are offered (directly or indirectly) or how the fund invests their money (see page 17).
- Investigate the operation of a comprehensive retirement test, across a broad set of factors including investment performance, flexibility to access funds in retirement, and giving people control over the level of risk they want (see page 21).

These issues continue to be raised by SMC stakeholders and warrant further examination.

Principles to guide policymakers when considering future changes to the test

When making changes it's important to apply a set of principles, both to provide clarity to stakeholders and to ensure a consistent approach.

Recommended principles to guide test improvements

- Simple improvements can and should continue to be made to the test and without the need for pause, delay, or cessation of the test.
- Any changes to the test should ensure it remains fair, effective, and transparent.
- Changes should only be made after careful research and analysis to confirm a benefit to members, long term.
- Proposed changes should also be assessed against key principles outlined in the consultation paper, and against the Best Financial Interests Duty.
- They should never diminish consumer protections and instead, should aim for universal application across the superannuation sector to ensure all consumers benefit from the operation of the test.

The performance test – how well is it working?

SMC supports the operation of a performance test that holds trustees to account for net investment performance, encourages the improvement or exit of poor performing products, and protects and promotes the interests of super fund members.

The current performance test has led to better results for super fund members, through:

- reductions in total fees across most MySuper products;

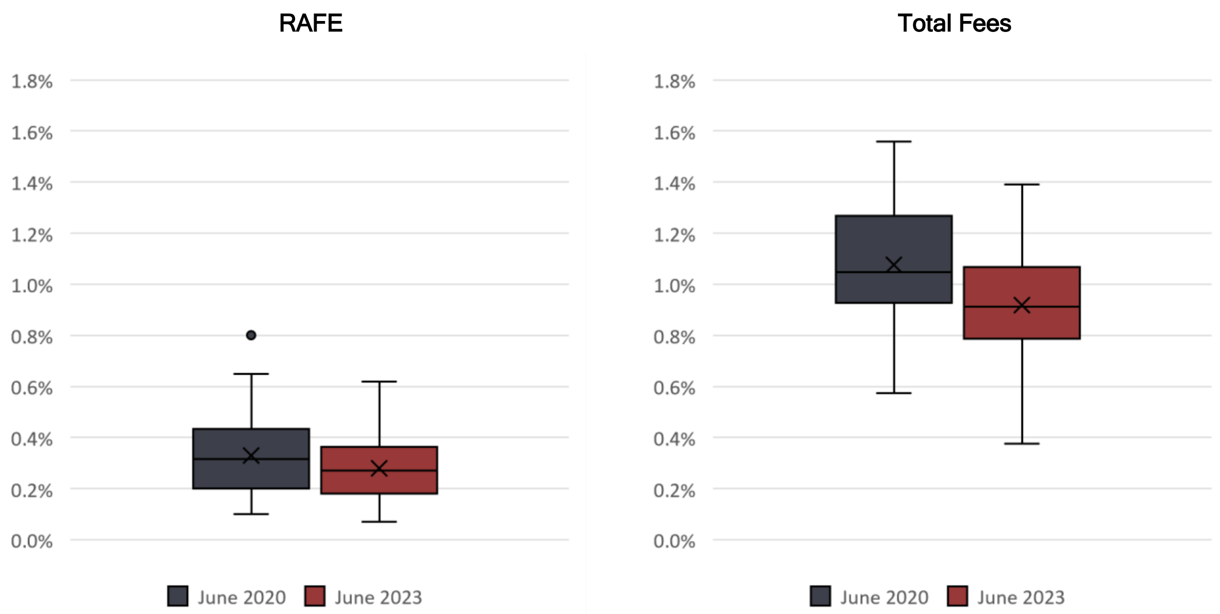
- the exit of a number of underperforming MySuper products and transfer of members to better alternatives; and
- delivering metrics that allow quantitative assessment of the value trustees have added (or subtracted) from member savings relative to benchmarks.

Evidence of better results for super fund members

Fees have reduced since the inception of the test

Since the test began, representative administration fees and expenses (RAFE) have declined, with a diminished spread between the lowest and highest RAFEs. Median RAFEs for a representative super fund member have declined by a modest 5 basis points (0.32 per cent to 0.27 per cent), however median total fees have reduced by 13 basis points (1.05 per cent to 0.91 per cent). **80 per cent of MySuper products have recorded total fee reductions since the test began, delivering aggregate fee savings of almost $1 billion in 2022-23.**

Chart 1: Change in the distribution of MySuper product RAFE's and total fees, 2020-2023

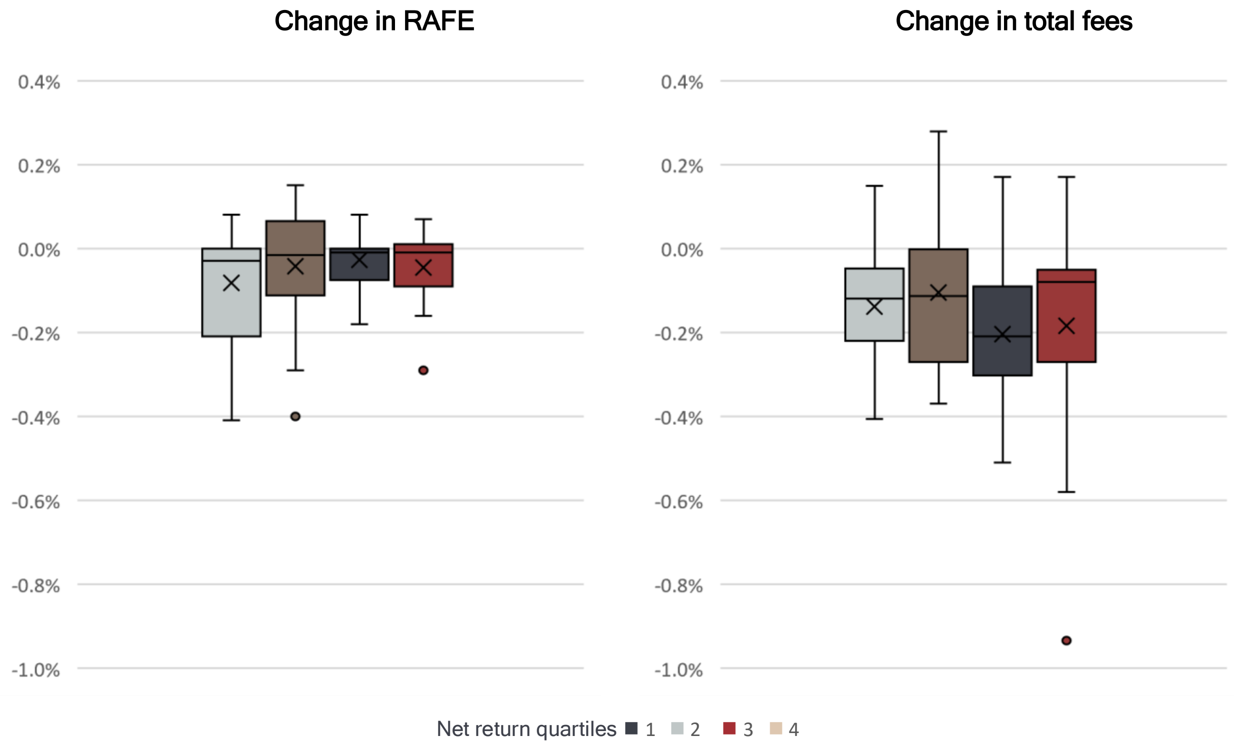


Source: SMC Analysis, APRA Quarterly MySuper Statistics (June 2023)

Fee changes by performance rank

It's useful to consider the distribution of fee changes by net return cohort to assess where fee changes are occurring. Chart 2 below shows the distribution of fee changes from 2020 to 2023 by 9-year net return quartile. At the median level, total fee reductions are evident across all performance quartiles. Although mean fee reductions are more significant among the top two quartiles, fee reductions apparent in the bottom two quartiles, while welcome, are not sufficient to materially improve member outcomes for members in these poorer performing products.

Chart 2: Fee change distribution by net return quartile, 2020-2023



Source: SMC Analysis, APRA Quarterly MySuper Statistics (June 2023),

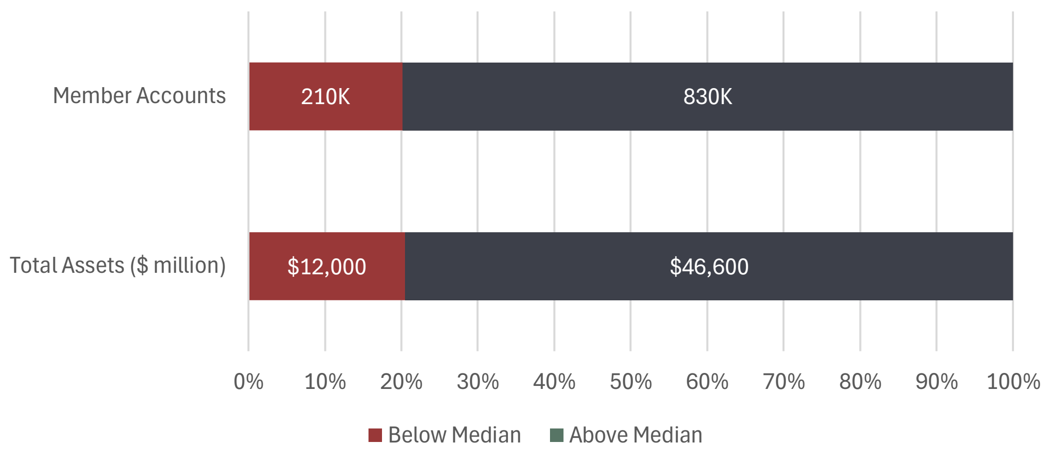
What’s occurred with products that failed - successor funds and member outcomes

Transfer of members to better products

It is a positive development that almost all MySuper products which failed the test have either exited the market or improved their performance. The consultation paper notes that over 800,000 member accounts in MySuper products that failed the test have been transferred to better performing products. However, new SMC analysis of member movement reveals a concerning trend. While people in failing MySuper products often get switched to better performing ones, the extent of the performance uplift is far from guaranteed.

- Of the over 1 million super fund members affected by failing products, around eight in ten landed in products with above median returns. However, two in ten (210,000 members) transferred or remained in poor performing products (see Chart 3).

Chart 3: Proportion of accounts and assets of failed MySuper products in above/below average products



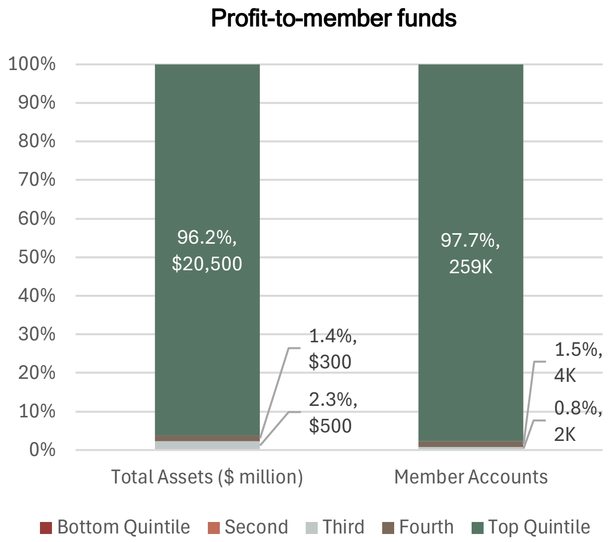
Notes: The analysis includes outcomes for members of AMG MySuper and Colonial First State FirstChoice Employer Super which have failed previous performance tests but have not merged. Product performance is based on annual average net investment return from inception to June 2023. Member accounts rounded to the nearest 10,000 and total assets rounded to the nearest $100 million.

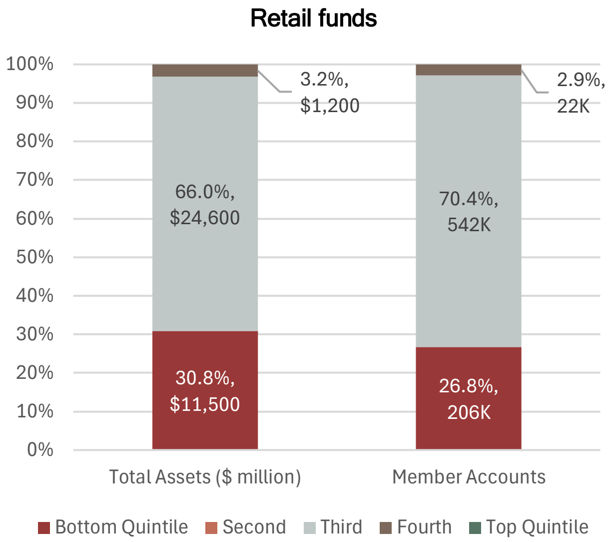
Source: APRA Extended Performance Test 2022-23 results, APRA Heatmaps 2022, APRA Heatmaps 2021, APRA Annual MySuper Statistics (June 2023), APRA Quarterly MySuper Statistics (June 2023).

There are concerning sectoral differences in outcomes. For example, some members in retail MySuper products were transferred between products that failed the test – with only subsequent testing rounds prompting the transfer of members to a better alternative. In contrast, the results for members of profit-to-member MySuper products were unambiguously positive. Where a product failed the performance test, almost all members were transferred either to a top-performing alternative (in 97.7 per cent of cases affecting around 260,000 super fund members) – or to a strong-performing alternative product (in 1.5 per cent of cases affecting around 4,000 super fund members). No members in the profit-to-member sector were transferred to a product in the bottom two quintiles.

The situation for Australians with their super in retail MySuper products is less encouraging. None of the failing products led to transfers into top-performing options. Instead, 206,000 members ended up in the bottom tier, and 542,000 in the middle quintile (See Chart 4).

Chart 4 Proportion of accounts and assets of failed MySuper products in products split by NIR quintiles



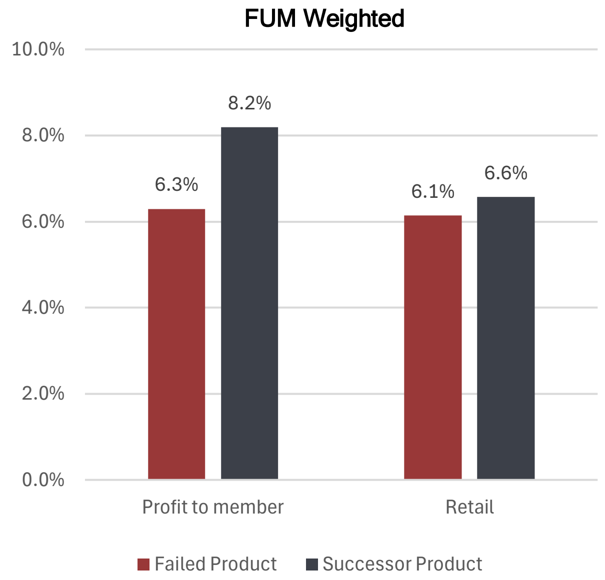


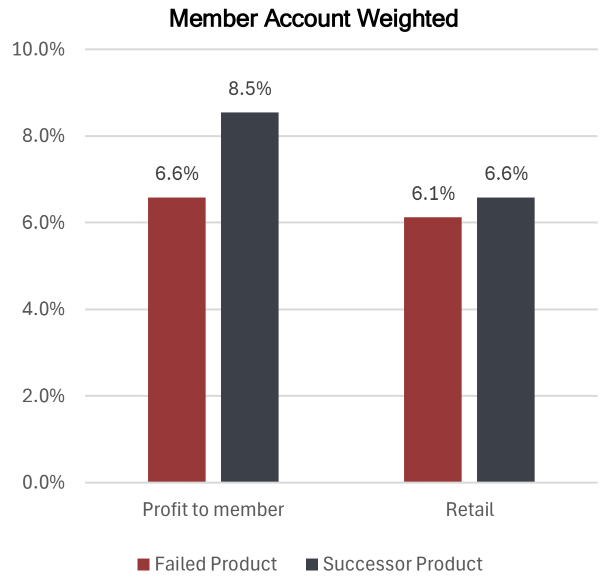
Notes: The analysis includes outcomes for members of AMG MySuper and Colonial First State FirstChoice Employer Super which have failed previous performance tests but have not merged. Product performance is based on annual average net investment return (NIR) from inception to June 2023. Member accounts rounded to the nearest 1,000 and total assets rounded to the nearest $100 million.

Source: APRA Extended Performance Test 2022-23 results, APRA Heatmaps 2022, APRA Heatmaps 2021, APRA Annual MySuper Statistics (June 2023), APRA Quarterly MySuper Statistics (June 2023).

Another way to look at the effect of the test is to examine the uplift in returns for members in failed products (see Chart 5 below). Again, there is a marked difference in outcomes for members between MySuper products offered by profit to member and retail trustees.

Chart 5: Weighted average net investment return of failed and successor products.





Notes: Net investment return uplift is calculated with respect to the initial transfer to a successor fund and does not include subsequent transfers. Net investment returns are calculated up to the final year of failed funds. Total asset and member accounts of failed funds are assumed to be fully transferred to successor funds and are used as weights. The analysis includes yet to merge products: AMG MySuper and Colonial First State FirstChoice Employer Super.

Source: APRA Extended Performance Test 2022-23 results, APRA Heatmaps 2022, APRA Heatmaps 2021, APRA Annual MySuper Statistics (June 2023), APRA Quarterly MySuper Statistics (June 2023).

This highlights a critical issue: the performance test removes members from failing products, but it doesn't guarantee a move to a genuinely superior option.

The vast majority of members rely on trustee decisions and the strength of in-built safeguards because most don't take any action themselves, and (as demonstrated below) few members in failing products transfer out of failed products.

Responses to Trustee-Directed Product failure

While it is also positive that the performance test has revealed the underperformance of many Trustee-Directed Products (TDPs), especially platform products, the high level of failure or poor performance is a serious concern (25 per cent of platform TDPs failed the test and 23 per cent are performing poorly).

Neither the consultation paper nor APRA have yet released information about the trustee and member response to the failure of TDPs.

The paper expects the test to be effective at removing underperforming TDPs, but this expectation should be translated into data about the numbers of products that have exited the market or improved performance, and the number of members that have left failing products as well as those that remain in them.

Recommendation	*SMC recommends that urgent steps be taken to facilitate the gathering and analysis of the impact of the test on TDPs that failed. This information may support the case to protect the interests of members of underperforming products more strongly.*

Consequences of failure

SMC agrees clear consequences of failure have made the super system more effective and efficient, although it should not be up to individual members to respond to a product's failure or leave an underperforming fund.

Under current rules, funds with products that fail the test are required to write to members using mandated text about its failure. This approach has not been a success, given so many super fund members have not been moved into better-performing super products. We highlight further evidence on this below (see the next section *Members stay with failed products)*.

Products that fail twice are not permitted to enrol new members, but this does not provide any protection to current super fund members in that product. One MySuper product that has failed three times still has one in three of their members in the product.

Given these existing issues, the consequences of failing the test should be strengthened. Strong consequences for failure enhance consumer confidence in the superannuation system, as members in many products are assured there are systemic protections in place.

Any reduction in consequences could also be seen as a reduction in the accountability of superannuation funds for their results. Reducing the impact of failure potentially leaves more underperforming funds in operation.

Funds with products that fail should have the responsibility to transfer the members in them to better performing products within a short period of time.

Members stay with failed products

The consultation paper suggests the 10 per cent fall in the number of accounts in failing products in the 5 months following the test as a "positive impact on member engagement."

SMC does not support this view as it also means 90 per cent of members in failing products remain in those products: by any measure, inspiring member action cannot be claimed to have been a success.

Rather, what these statistics suggest is that the mandated communication with members in failed products has not resulted in significant member movements from failing products.

The ASIC Review of trustee communications about the MySuper performance test found significant concerns with the quality of communication to the members of failed products:

> *Our review suggested that often the primary aim of trustees whose product failed the test was to retain members, even if this involved using communication strategies that potentially undermined good decision making by individual members. Examples of these kinds of strategies included not prominently disclosing a test failure or presenting information to discount the importance of the test.*[1]

SMC notes that the regulators are taking appropriate steps within the existing regulatory framework to hold trustees to account for poorly performing products. ASIC has stated it will continue to review trustee communications in future and act where issues are found, and APRA is requiring trustees of underperforming products to understand and act on the reasons for their failure.

However, this may not be sufficient to protect the interests of super fund members in products that fail the test. Even where members read the letter, it is not surprising that response levels are low. ASIC's report on Disclosure: Why it shouldn't be the default found that disclosure and warnings can be ineffective in influencing consumer behaviour.

Given the low rates of members proactively switching as a result of receiving the letter, SMC strongly recommends that the responsibility for exiting an underperforming product should not rest with members.

As it stands, members in failed products are at the mercy of the trustees of these products. As SMC analysis shows even where trustees transferred members from a failed MySuper product, the impact for members varied depending on the status of trustee, either profit-to-member or retail. For people in a failed retail MySuper product, none of the failing products led to transfers into top-performing options. Instead, around 206,000 members ended up in a bottom tier product, and around 542,000 members ended up in a third-tier product.

To address this, SMC recommends trustees with failed products should have the responsibility for transferring members in these products to a well-performing alternative.

Recommendation	*The consequences of failing the performance test be strengthened, so super funds with failed products should have an explicit obligation to transfer members in these products to better performing products in a timely way.*

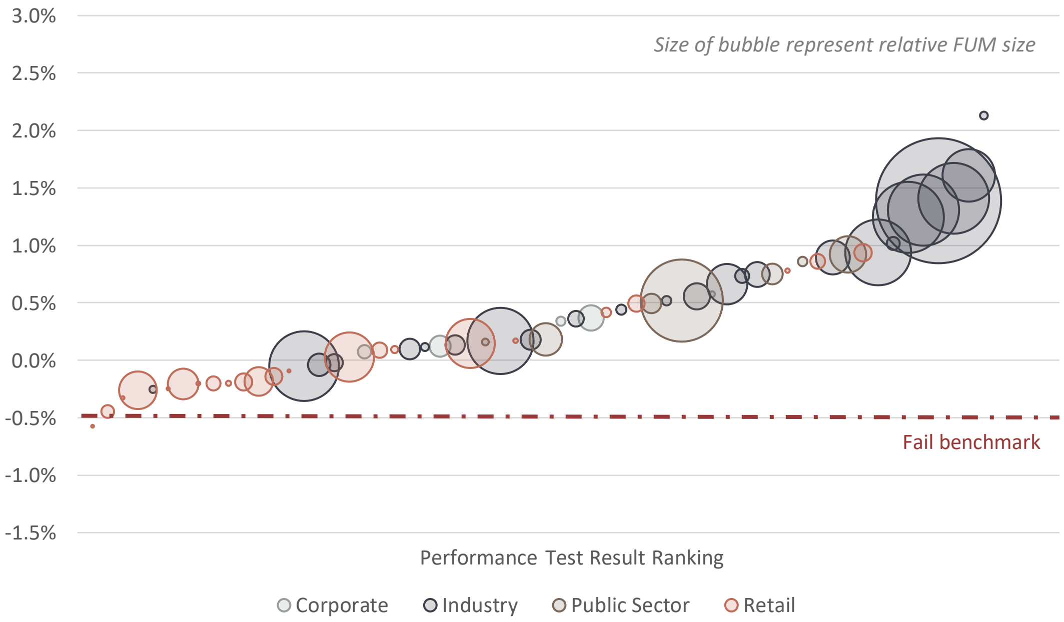
[1] Report REP 729 Review of trustee communications about the MySuper performance test (asic.gov.au), p.7.

Performance and Value-add

Notwithstanding the mixed outcomes of members who were transferred from failed products, the introduction of the performance test has created yardsticks to assess how trustees are adding value to members' super accounts. Although not a focus of coverage to date, it is now possible to see how funds are delivering better returns to their members than required by the reference benchmarks they are assessed against.

Chart 6 below shows the performance of individual MySuper products relative to the performance benchmarks they are assessed against. While there is a spread of performance test outcomes a large proportion of MySuper assets are clearly held in products that significantly exceed their benchmarks.

Chart 6: MySuper performance test outcomes by sector and size



Source: APRA Extended Performance Test 2022-23 results, APRA Quarterly MySuper Statistics (June 2023)

Table 1 below summarises the aggregate value add outcome across the profit to member and retail MySuper product landscape for each year since the test's inception and total cumulative value add to date.

Table 1: Sector value add, June 2023

Sector	Outperformance (2023)	Aggregate value-add ($M)			
		2021	2022	2023	Cumulative
Profit-to-member	0.91%	$4,756	$5,903	$7,825	$18,484
Retail	0.02%	-$431	-$230	$24	-$637

Source: APRA Extended Performance Test 2022-23 results, APRA Heatmaps 2022, APRA Heatmaps 2021, APRA Quarterly MySuper Statistics (June 2023)

An alternative way is to assess this for a representative super fund member with a balance of $50,000. The cumulative value-add since the test was introduced is that a person with their super in a profit-to-member fund saw their super balance grow by $1,165 over and above the benchmark return, and a person in a retail fund's balance was $246 less than if their fund had met the benchmark return. This reflects the movement of members to either well-performing or poorer-performing products and indicates there has been improvement evident across both sectors.

Table 2: Sector value add per representative member, June 2023

Sector	Average representative member value-add ($50,000 balance)			
	2021	2022	2023	Cumulative
Profit-to-member	$315.7	$391.9	$457.1	$1,164.7
Retail	-$163.9	-$91.0	$8.8	-$246.1

Source: APRA Extended Performance Test 2022-23 results, APRA Heatmaps 2022, APRA Heatmaps 2021, APRA Quarterly MySuper Statistics (June 2023)

MySuper sector outperforms the choice sector

APRA's insights on the performance test have demonstrated that the Choice sector underperforms the MySuper sector, with this underperformance most apparent in platform Trustee-Directed Products.

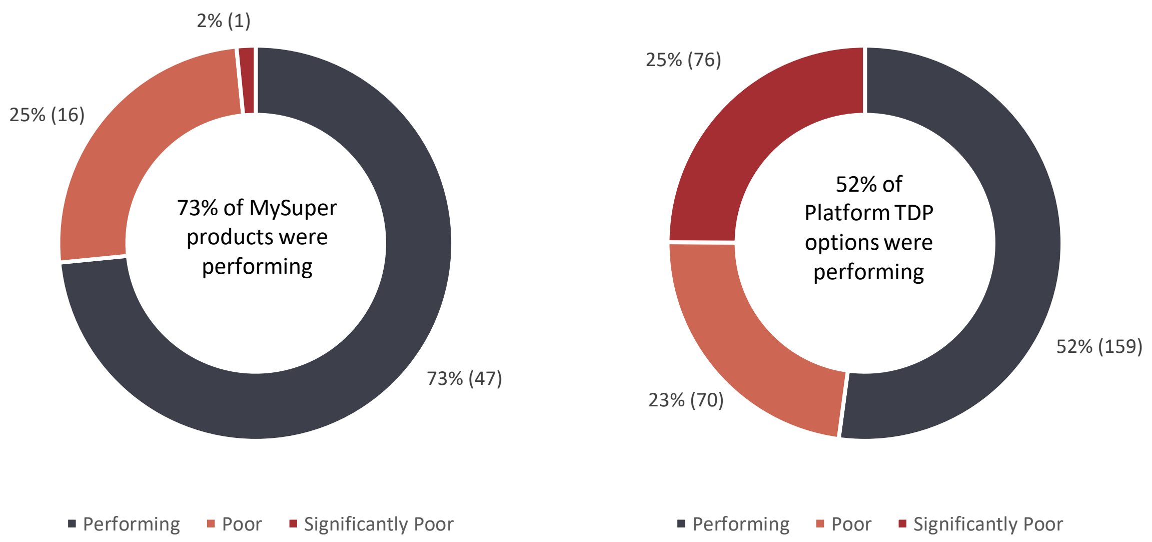
It is significant that performance issues are most apparent with products that have been subject to the least scrutiny. Choice products have been subject to lesser and delayed reporting requirements, less product comparison, and less performance assessment than MySuper products.

The high failure rate of platform TDPs, that have only been subject to one performance test, suggest that there is value to members in revealing the performance of other choice products by extending the performance test.

The variance in performance test results between Choice and MySuper products can be seen in Chart 7:

- MySuper products – 73 per cent exceeded their benchmarks in the performance test in 2022-23
- Platform TDPs – only 52 per cent exceeded their benchmarks in the performance test in 2022-23

Chart 7: The Choice sector significantly underperforms the MySuper sector. June 2023



Notes: Performing represents a performance test result over 0 per cent, poor is defined as between 0 per cent and -0.5 per cent, and significantly poor less than -0.5 per cent.

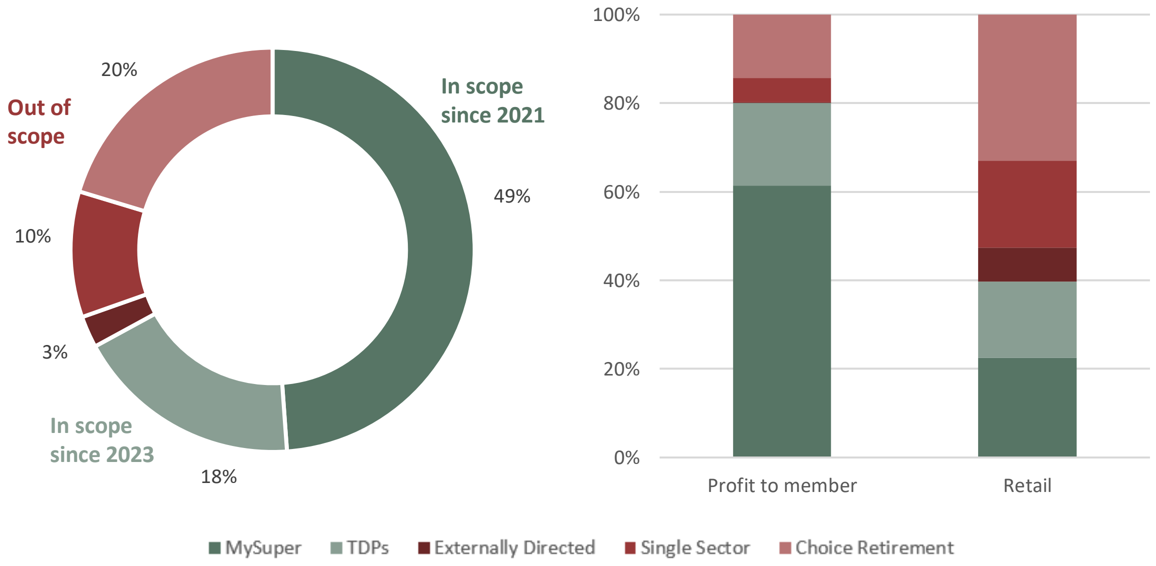
Source: APRA Extended Performance Test 2022-23 results

Coverage of the test across the product universe

The performance test covers MySuper and Trustee-Directed Products, leaving Externally-Directed, Single-Sector, and Choice Retirement products out of scope. These three sectors amount to $651 billion, or a third of APRA-regulated assets when excluding sectors impractical to test (see Chart 8). Single-Sector and Externally-Directed products alone account for $249 billion, or 16 per cent of APRA-regulated accumulation assets.

The existing scope of coverage of the test has significant sector variations. 80 per cent of profit-to-member assets are currently assessed, yet only 40 per cent of retail super assets are currently covered. This means many members who are members of retail super funds don't have the same transparency and performance safeguards in place.

Chart: 8 Superannuation coverage by sector



Notes: Chart excludes assets in Self-Managed Super Funds, Direct Assets, Defined Benefits, and Other (single member ADFs, small APRA funds, exempt public sector superannuation schemes, balance of life office statutory funds) sectors.

Source: Quarterly Superannuation Industry Statistics (June 2023); Expanded Performance Test 2022-23 results; Quarterly Superannuation Product Statistics (June 2023), APRA Annual Fund-level Superannuation Statistics (June 2023); Treasury analysis of APRA data.

The status quo and options for change

The establishment of a performance test in 2021 as part of the Your Super Your Future reforms significantly increased the focus on trustee accountability for superannuation product performance. The expansion of the test to Trustee-Directed Products further increased this focus, and many members now have improved access to performance information about their superannuation products.

The following comments are made in the context of requiring an objective assessment of the status quo and all the options proposed in the consultation paper (using an appropriate evidence base and against the key principles) prior to making significant changes to the test.

SMC is not suggesting that one or other of the options should be selected if the issues identified below are addressed: an evidence base justifying change is still required.

The exception to this is in relation to some changes that should be made to the current test (e.g., changing the time period for considering administration fees in the test). However, it should be possible to both make these changes and continue the process of gathering data and evaluation for possible further options for change.

The current test should not be paused or stopped while further consultation takes place and changes flowing from the consultation are being implemented.

Alternate design option

SMC agrees the options in the consultation paper ‘help start the conversation’ but is concerned they may also inadvertently result in a premature tilt toward one or other of the options. A full assessment of the performance test to date and consideration of other modelling of the options and their impact on member outcomes is needed as a precondition to making final decisions about changes to the test.

As can be seen by the high-level review of the proposed options against the proposed key principles (Appendix 1), numerous gaps exist for each of the options. Addressing these requires careful consideration.

Principles

SMC supports a principles-based approach to assessing the status quo and options for potential changes to the testing framework and agrees with the principles proposed in the consultation paper that the test should:

- Improve member outcomes
- be effective and efficient
- be widely applicable and transparent
- be enduring

Yet the consultation paper does not assess each design option against its key principles. Rather, the focus of the commentary on the options for consideration is on practical issues and consequences of each option.

SMC believes a sound evidence base is essential to make a definitive assessment of the status quo and the options in the consultation paper, or any other proposed options, and no major changes to the performance test should be made without this analysis. As a starting point, the status quo and the options can be assessed against the principles articulated in the consultation paper. This should be done and will assist the Government to decide next steps.

This approach is consistent with assisting in the evolution towards an enduring test to deliver a dignified retirement for more Australians.

SMC also suggests the principle of simplicity be added as a key principle. Simplicity could be defined as follows:

Principle	Description
Simplicity	A simple test will be easier for all stakeholders to understand and support better decision-making. Simplicity will enhance transparency of test results, assist comparison between products, and reduce opportunities to game the results.

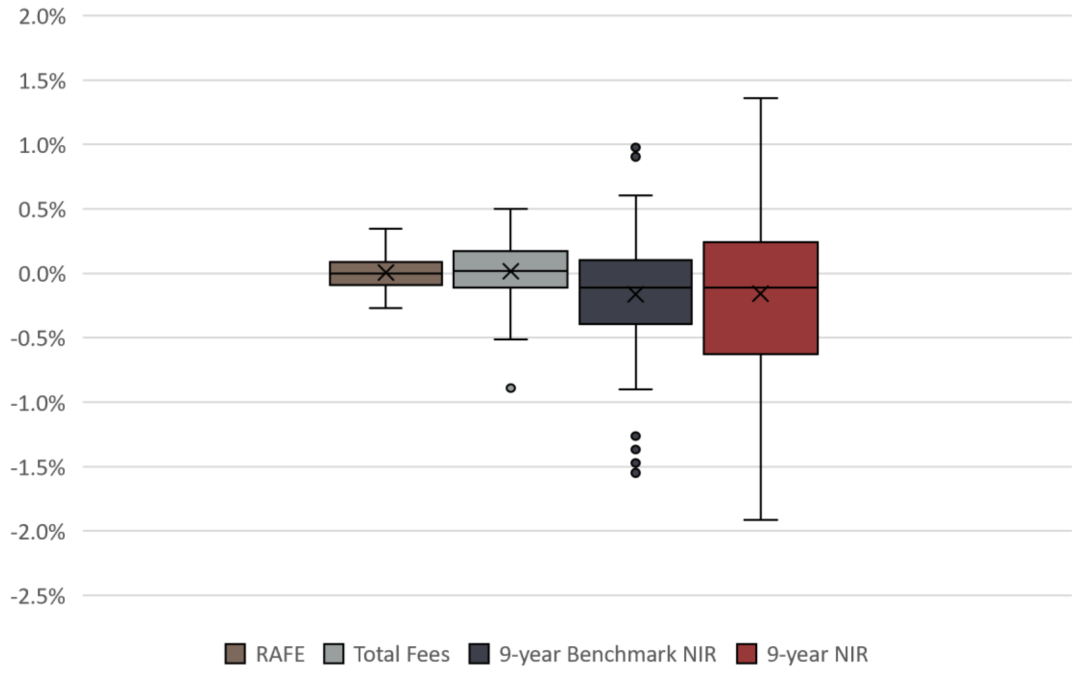
There is room for improvement in the current test

Status quo – use of the SAA Benchmark Portfolio

As noted in the consultation paper, the existing YFYS performance test assesses the ability of a trustee to implement its strategy and fees and costs incurred in doing so relative to a tailored Strategic Asset Allocation (SAA) benchmark.

A key consequence of this approach is that it does not assess the quality of the strategy that is set including the mix of broad asset classes that deliver returns to members. The importance of this can be shown in Chart 9 below which decomposes the extent to which variations in fees (admin fees and total fees) and the SAA benchmarks might contribute to variations in observed returns.

Chart 9: Spread of factors affecting net return, June 2023



Source: SMC Analysis, APRA Quarterly MySuper Statistics (June 2023), APRA Extended Performance Test 2022-23 results

Clearly fees, while an important and easily measured component, only explain perhaps one-third of the observed performance differences with most of the difference accounted for by asset allocation and implementation. Further consideration of improvements to the test should more fully consider the broader set of factors that contribute to net return outcomes.

Recommendation	*SMC recommends further consideration of the broader set of factors that contribute to net return outcomes for members including the quality of the strategy and management of risks and how they can be better captured in the test*

Measuring risk return efficiency

It has been widely and often noted (including in the consultation paper) that using a benchmark portfolio only marks the implementation of an investment strategy, and not the decision to set that strategy or account for management of risk on behalf of members.

Trustees seek to manage a complex range of risks when constructing investment portfolios for members – these include market risks, inflation risks, regulatory risks, implementation and manager risks, transition risks, and currency risks, to name just a few.

The current performance testing regime does not reward funds for the skilful management of these factors.

The consultation paper outlines some additional metrics to better assess the risk return trade-off including the Sharpe ratio and standard deviation (volatility) of returns. There are others which are utilised by investment professionals, but none is comprehensive in assessing the management of risk.

Nevertheless, risk is an important concept to evaluate, and one which members can be sensitive to. Previous efforts to define risk, such as the standard risk measure (SRM) have shortcomings including the potential magnitude of losses that a member might be exposed to rather than just the frequency of negative returns.

The consultation paper identifies alternative metrics to assess risk, distinct from the product-specific Strategic Asset Allocation (SAA) benchmark. Consideration of these alternative metrics should investigate if they would result in significantly different test outcomes (see Table 1 p 26 of Consultation Paper).

Administration fees

Administration fees are a crucial factor in the performance of superannuation products because they directly affect the net returns members receive. It is therefore appropriate that the performance test includes consideration of administration fees.

As a matter of principle, the effect of administration and investment fees on net returns assessed by the performance test must be identified, taken into account and treated consistently. The current test does not do this – so now is the opportunity to make changes to better account for them. The changes recommended by SMC in relation to these fees can be progressed in the short-term while there is longer-term consideration of options to change the performance test.

However, there are two major structural problems with the treatment of administration fees in the current performance test which reduce the extent to which the test delivers the best outcomes for all members.

The following changes recommended by SMC should be assessed in the Government's response to this stage of consultation, and changes can be made with little or no impact on investment strategies.

Separate administration fee benchmarks for different types of funds

The decision to test administration fees separately for MySuper, platform TDPs and non-platform TDPs is based on the unsupported and untested premise that each type of product provides materially different services to members and therefore should be assessed as such. SMC submits that the next stage of consultation should consider whether there is any objective basis for this premise.

On the face of it, there are significant similarities between each type of fund. Each requires strategic asset allocations to multiple asset classes, and typically have diversified investment strategies. As a general rule, a member should be able to rely upon a product in any of these product types to deliver their retirement income.

The consultation paper argues that platform TDPs are expected to have a higher level of member services for which members are prepared to pay a higher administration fee. This view should be tested, as in practice, the services provided are generally to the adviser, not the member. In addition, it is worth noting that the fees for Platform TDP's do not take into account financial adviser fees.

While platform TDPs may promote access to tailored investment strategies, and a wide range of investment choices, performance monitoring, financial advice, educational resources and other tools, these services are now routinely available from almost all super funds that provide MySuper products.

Using a separate administrative fee benchmark for TDPs may also and inappropriately entrench high fees with significant profit margins.

The APRA Insights paper on the 2023 performance test revealed platform TDPs generally have the highest administration fees with a Benchmark Representative Administrative Fees and Expenses (BRAFE) that is roughly twice (0.54 per cent) that of non-platform TDPs (0.27 per cent) and MySuper products (0.26 per cent).

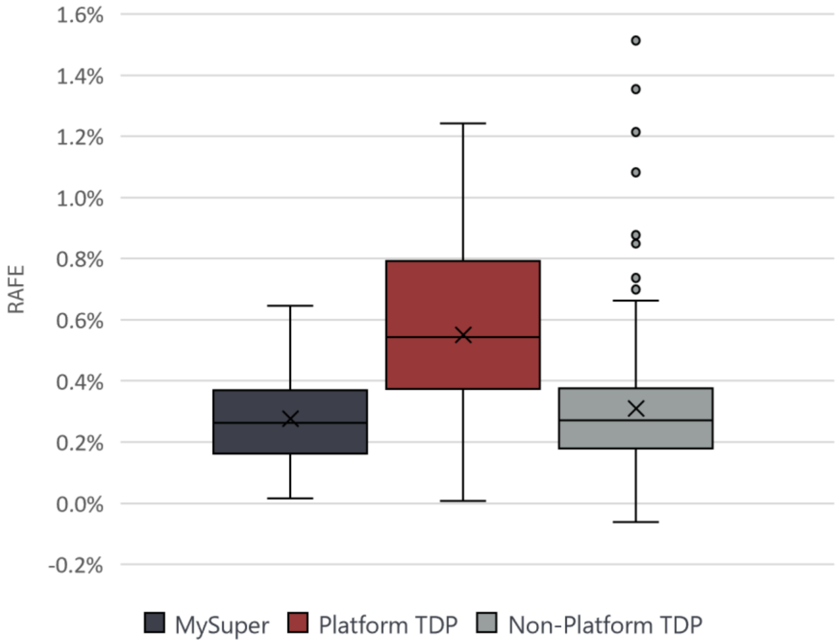
APRA concluded:

> *Some trustees offering platform TDPs may need to review their administration fees to ensure the additional services provided to members justify their higher fees and are providing value for money for members.*

SMC suggests having a much higher level of fees for this type of fund incorporated into a separate benchmark for platform TDPs distorts the operation of the performance test for these products and makes it easier for them to pass the test.

Chart 10 and Table 3 below demonstrate the difference in RAFE for the different product types currently captured by the performance test.

Chart 10: Representative administration fees and expenses (RAFE) for MySuper, platform trustee-directed products (TDPs), and non-platform TDPs (June 2023)



Source: APRA Extended Performance Test 2022-23 results

Table 3: Summary statistics for RAFE – June 2023

	MySuper	Platform TDP	Non-Platform TDP
Median (BRAFE)	0.2618%	0.5432%	0.2716%
Mean	0.2757%	0.5502%	0.3109%
Minimum	0.0168%	0.0075%	-0.0624%
Maximum	0.6452%	1.2423%	1.5139%

Source: APRA Extended Performance Test 2022-23 results

Recommendation	*SMC recommends a single administration fee benchmark based on member weighting be incorporated into the performance test.*

Time period for assessing administration fees

The consultation paper proposes that using administration fees over the most recent 12 months creates a strong and intended driver for underperforming funds to reduce fees to improve their results. To the extent there was merit in that position, it will have been exhausted after a few years of performance testing because manufacturers have already responded to that driver.

The performance test should be based on administration fees for the full duration of the test so that they both

- accurately reflect the outcomes received by members; and
- incentivise funds to not only reduce administration fees but to keep them low.

Further, the BRAFE should be based on a member-weighted administration fee rather than a product-weighted fee.

One way of incorporating the full history of administration fees is to revisit the methodology proposed via YFYS consultation in 2021. This methodology tested a product by comparing its annualised net return - already net of a product's RAFE at the quarterly level, unlike the net investment return currently in use - to the product's corresponding annualised benchmark return over the same lookback period.

Instead of calculating an annual BRAFE for the last year of the lookback period, it can be calculated quarterly by taking the median across product RAFEs at each quarter. The final benchmark return formula effectively augments that of the current test to subtract the quarterly BRAFE from each quarter of the benchmark return series before annualising.

Recommendation	*SMC recommends administration fees be assessed over the same period as investment performance, that is, ten years.*

Investment fees

Investment fees are also a crucial factor in the performance of superannuation products because they also directly affect the net returns members receive. It is appropriate that fees and costs borne by members are treated consistently regardless of how products are offered to members and how funds access underlying investments.

There have been ongoing issues with fee disclosure under ASIC’s RG 97 (fee and cost disclosure) which has seen some notional fee increases of many high performing products (including for instance defining taxes such as stamp duty which are levied on the acquisition of real assets purchased directly by funds as fees). This has a direct impact on the fees used in the performance test.

Changes in product level fee disclosures that bear little relationship to after-fee and after-tax return outcomes experienced by members suggest ongoing problems with fee disclosures related to RG 97. In many instances trustees have been required to disclose arbitrary changes associated with how fees and costs have been defined by RG 97 rather than any change in underlying fees or costs borne by members.

Additionally, concerns remain about the neutrality of the disclosures linked to the way in which funds offer investment options to members (whether directly by the trustee or via platforms) and the way in which funds acquire and hold assets.

Recommendation	*The basis for fee and cost disclosure by super funds (ASIC’s Regulatory Guide RG 97) and related data collections used for performance testing should be reviewed by Government to ensure fees and costs borne by members are treated consistently regardless of how products are offered to members and whether funds access underlying investments directly or indirectly.*

Coverage

Improvements to the YourSuper comparison tool

The Government has already demonstrated that small but important changes can be made to the performance test architecture, improving member visibility, and understanding of the test, without causing disruption to investment strategy, or creating additional administration.

On 30 May 2023, the Government changed the YourSuper comparison tool's default sorting of products to net returns rather than by fees. SMC supports this change as net return is the most important metric in the test.

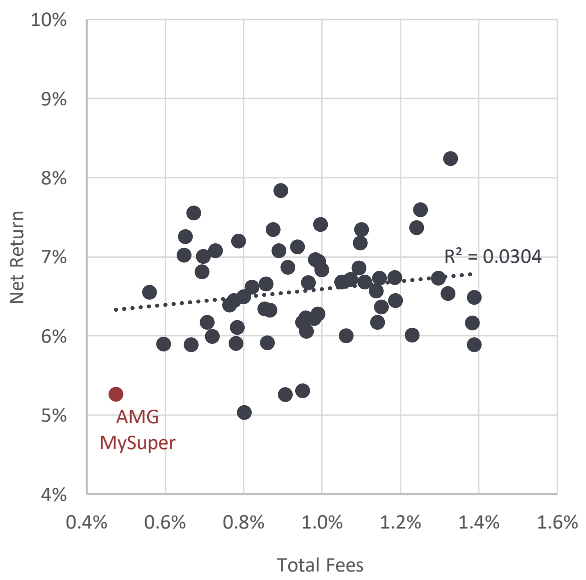
The tool's previous default sorting of products by fees may have led to products with temporarily lowered fees being placed at the top of the comparison tool. This would not have reflected the fees members would pay in the future, and in some cases these products may have a poor investment performance. The correlation between fees and net returns is weak (see Chart 11), while there is a stronger correlation between the default rankings of the YourSuper Comparison tool and long-term net return (but more so for single strategy products).

By making the change, the Government recognised that the most important metric was net returns. In providing the most important information in this way, the change has increased visibility of returns and may contribute to member engagement.

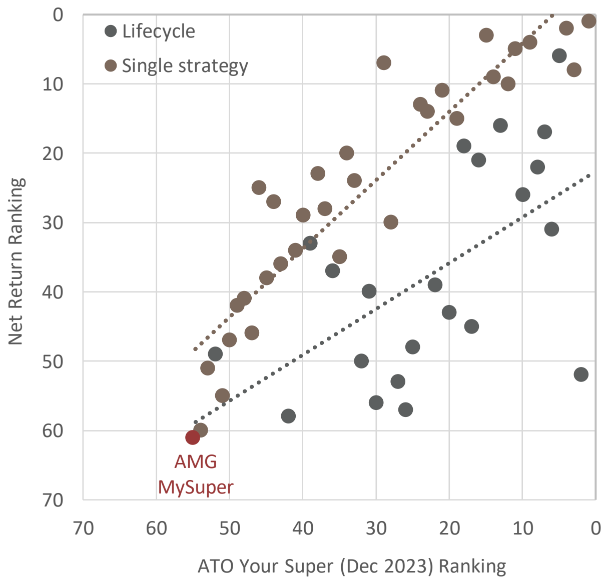
The YourSuper comparison tool currently displays MySuper products only.

Chart 11: ATO Comparison Tool

Total fees vs net returns, June 2023



Default sorting vs net return rank



Source: APRA Extended Performance Test 2022-23 results, APRA Quarterly MySuper Statistics (June 2023), ATO YourSuper Comparison Tool (December 2023)

Recommendation	*SMC recommends extending the YourSuper comparison tool to other accumulation products, with comparisons provided for each type of superannuation product with similar risk characteristics.*

As well as the specific benefit this would provide for members seeking to compare products, changes such as this are also indicative of an ongoing commitment by the Government to communicate with the public about improving transparency and accountability in superannuation. In the event a product is not covered by the comparison tool, this should be stated on the tool.

Retirement products

SMC agrees with the comment in the consultation paper that a performance test for the retirement phase could aim to link more closely with trustee obligations under the Retirement Income Covenant. This is a view that SMC promoted in our submission to the recent Treasury discussion paper on the retirement phase.

SMC also notes the comments in the consultation paper that options to refine the retirement phase policy settings are being considered separately. Notwithstanding this, SMC makes the following comments and recommendation to reiterate the comments we made in response to the retirement phase discussion paper.

Appropriately designed quality filters can improve trust and confidence in the system and enable individuals to assess performance, value for money and reliability of retirement income products. This allows members to make more informed decisions relevant to their retirement objectives and circumstances, ultimately enhancing confidence in their decision making. They also enhance consumer protections and provide assurance that products meet minimum standards by weeding out substandard products from the market and enhance competitive tensions and system efficiency.

Funds are already subject to a range of fiduciary obligations that seek to improve quality and guide member-centric product design, distribution, disclosure, and assessment. These include:

- **Design and distribution obligations** including target market determinations, which require financial firms to design financial products to meet the needs of consumers and to distribute their products in a more targeted manner.
- **Member outcomes assessments** which require funds to regularly assess the outcomes provided to members and identify opportunities for improving these outcomes, with regard given to investment returns, fees that impact the return and the level of investment risk.
- **Retirement Income Covenant (RIC)** which requires funds to formulate a strategy for how they will assist members who are at, or approaching, retirement and balances the objectives of maximising income, managing risk, and permitting flexible access to funds over the period of retirement.

Both regulatory oversight and member visibility of performance have seen a step change through independent benchmarking as part of the YFYS performance test and APRA superannuation heatmaps which focus on investment products, fees and costs, and sustainability of member outcomes.

However, simply transferring the accumulation test to retirement may not be fit for purpose. Any test used to assess retirement products needs to reflect the unique characteristics underpinning their design and objectives for members. These can be materially different to accumulation products.

A quality filter should consider the objectives of the RIC, i.e. maximise expected retirement income; manage expected longevity, investment and inflation risks to the sustainability and stability of retirement income; and provide flexible access to funds during retirement. The filter should assess product quality, how effectively it's being managed, and the quality of guidance being offered to members.

Recommendation	*As part of the Government's review of the retirement phase and in alignment with this review of the performance test, SMC recommends the Government develop a quality filter for retirement products, to provide confidence to members who are in or approaching retirement.*

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Appendix 1: Proposed options assessed against proposed key principles

Principle/Option	1. Current Test	2a. Sharpe ratio	2b. Peer comparison of risk adjusted returns	2c. Risk-adjusted returns relative to Simple Reference Portfolio (SRP)	3a. Heatmap	3b. Targeted three-metric	4. Alternative metrics
Improves member outcomes	**Strength:** Has improved outcomes for MySuper products. **Weakness:** Impact on TPDs unclear.	**Strength:** Focuses on returns. Easier to understand **Weakness:** Lacks sufficient modelling and evidence base. Doesn't include admin fees.	**Strength:** Pivots towards best risk-adjusted returns. **Weakness:** Lacks sufficient modelling and evidence base.	**Strength:** Assesses skill of strategy. **Weakness:** Lacks sufficient modelling and evidence base.	**Strength:** Has contributed to improved outcomes. Provides multiple performance perspectives **Weakness:** May be subject to short-termism.	**Weakness:** Lacks sufficient modelling and evidence base.	**Weakness:** Lacks sufficient modelling and evidence base.
Effective and efficient	**Strength:** Incremental changes can improve without disruption. Assesses implementation of strategy. Adverse	**Strength:** Simple, can use APRA data. **Weakness:** Assumes normal return distribution. Pivots away from volatility regardless	**Strength:** Promotes competition. Uses growth exposure as a proxy for risk. Progressively raises the bar.	**Strength:** Multidimensional. May assist evaluation of new asset classes. **Weakness:** Additional complexity.	**Strength:** Industry familiarity. Harder to game. **Weakness:** Unclear how to combine metrics and set a pass/fail.	**Strength:** Provides a comprehensive assessment. **Weakness:** Unclear how to balance/rate different metrics.	**Strength:** May support innovation. **Weakness:** Uncertain outcomes. Likely to take years to develop and implement.

	consequences for failure. **Weakness:** Doesn't assess skill of strategy. Some funds investment strategies may be constrained.	of returns. May change strategies away from BFID.	**Weakness:** Lack of consistent growth/defensive labels. Higher failure rates as products exit.				
Widely applicable and transparent	**Weakness:** Poor benchmarks for some asset classes. Many products not covered by test.	**Weakness:** Unsuitable for niche strategies & single sector products.	**Weakness:** Not suitable for all products or asset classes.	**Strength:** Widely applicable. **Weakness**: May be hard to explain.	**Strength:** Widely applicable. **Weakness**: May be hard to explain.	**Strength:** Widely applicable. **Weakness**: May be hard to explain.	Too early to tell.
Enduring	**Strength:** Incremental changes can be made. **Weakness:** Some changes needed.	**Weakness:** Unlikely to be suitable by itself.	**Weakness:** Change in market composition will require review.				Too early to tell.
Simplicity (additional proposed principle)	Moderate.	Simple, can use APRA data			Weak.		Too early to tell.