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Exposure Draft Superannuation Performance Test Regulations 2023

Cbus welcomes the opportunity to comment on the Superannuation Performance Test Exposure Draft Regulations and Explanatory Materials.

About Cbus

Cbus Super was established in 1984, created by workers for workers. We are a proud industry super fund, representing those that help build Australia.

As one of Australia's largest super funds, we provide superannuation and income stream accounts to more than 875,000 members and manage over $73 billion of our members' money (as at December 2022). Cbus is a top performing fund and has a long history of strong returns, with an average annual retorn over the last 38 years of 8.88%[1].

The Fund has a history of investing back into our community – supporting industries that are important to our members and creating better retirement outcomes. By acting as a direct investor on our member's behalf, the Fund is a provider of significant capital to businesses around Australia. This funding will help to strengthen the Australian economy and drive higher returns for our members.

[1] As at 30 June 2022 for the Growth (MySuper) option and based on the crediting rate.

Performance test methodology

Cbus supports the role of the performance test in addressing underperformance within the superannuation sector and welcome the proposed changes that fix flaws in the methodology and ensures that the benchmarks are better aligned with how funds actually invest.

In particular we support:

- The inclusion of emerging market equities benchmarks - given this is often a standalone asset allocation with its own risk/return profile compared to developed market equities.
- Changes to unlisted infrastructure benchmark - the proposed change should better represent the profile of a traditional core infrastructure portfolio and be more representative of the index constituents.
- Longer term period - The proposed 10-year timeframe would better align to how superannuation funds actually invest and ensure alignment with other disclosures to members such as investment return objectives and MySuper Dashboard requirements.
    - Given the proposed performance history time horizon is being extended by 2 years – we also suggest that the minimum testing time horizon requirement for new products is also extended by 2 years, from 5 years to 7 years. This would better align with the long term nature of superannuation, noting that 5 years is a very short time period in the context of members have multiple decade superannuation holdings and funds typically targeting investment objectives over rolling 10 year periods.
- Immediate application of proposed benchmark changes – given the proposed benchmark changes address clear shortcomings in the performance test, we support the approach that the proposed benchmarks apply when assessing historical performance. It is also noted that due to recent changes to data reporting requirements we do not expect there to be a need for extensive resubmission of previous data, given that more granular asset allocation data was already provided to APRA last year.

Administration fees

Cbus does not support the administration fee component of the performance test continuing to be based on the most recent financial year. We believe that any assessment of net performance must be reflective of the actual fees charged to members at the time and ultimately the actual net return that a representative member would have received. In its current form the performance test is misleading, inconsistent and most importantly does not reflect actual member outcomes.

Whilst we appreciate the intention of the change was to incentivise funds to reduce administration fees, we believe that misrepresenting historical net returns is not the best way to encourage funds to reduce administration fees.

Granular benchmarks

Whilst Cbus supports the proposed addition of these further benchmarks, and we are comfortable on balance with what has been proposed in the draft regulations, our strong preference would be that there are not ongoing changes to benchmarks, which creates uncertainty and inconsistency. In this regard, further changes should be very limited or ideally not at all in our view. Finally, we believe that the inclusion of further benchmarks beyond these will just create more complexity and potential inconsistency in how different funds assigns their asset classes and sub asset classes.

As noted in our earlier submissions we also believe that the performance test could be revamped to capture SAA construction and consideration could be given to the use of a simple naïve 70/30 reference portfolio. This would significantly simplify the process for the regulator and would also avoid the various issues that can occur with how different funds classify investments and the selection of benchmarks made for the test. In addition, it would better acknowledge that the construction of the SAA is a core and critical function that ultimately drives a significant portion of members' long-term returns.

Cbus also has concerns regarding the proposed International Unlisted Property Index [MSCI Global (Excl. Pan-Europe and Pan-Asia Funds) Quarterly Property Fund Index (Unfrozen) (Net Total Return; AUD fixed). We support the AIST position of deferring implementation of an International Unlisted Property Index until a more representative index can be formulated and are concerned about the practice of a new benchmark as we understand it is being effectively created from scratch less than three months before the end of the financial year with limited or no industry input.

Recommendation: Administration fees should reflect actual administration fees incurred at the time

Recommendation: The performance test should be revamped to capture the SAA construction. Consideration could be given to a simple naïve 70/30 reference portfolio as one way of achieving this aspect

Recommendation: Consider the incorporation of other metrics in the performance test, for example those that capture risk and consistency more explicitly

Recommendation: Consider the use of a secondary risk-based assessment if a product fails the initial quantitative test

Recommendation: Consider extending the minimum testing time horizon requirement for new products by 2 years, from 5 years to 7 years

Recommendation: Defer the implementation of an International Unlisted Property Index until a more representative index can be formulated

Consequences of failure

Given that any performance test when applied across an entire industry is likely to have imperfections and limitations, consideration should be given to how a fund is ultimately considered to have failed and the consequences which are applied.

One additional option is a secondary risk-based assessment for funds which fail the initial quantitative test. This secondary risk-based assessment could be a more sophisticated assessment and could consider a broader set of information including any additional context to the drivers of the outcome and any forward-looking considerations.

This approach would better identify persistent underperformance and provide a basis for legislating stronger consequences for funds which fail both stages of the test – ensuring the members are not left to languish in underperforming legacy products. The current approach – which relies on members actively switching out of underperforming funds does nothing to protect disengaged existing members that do not switch out of underperforming products.

Notification letter

Cbus supports the proposed changes to the mandatory content information within the trustee notification to beneficiaries upon failing the performance test. Given the importance of insurance within superannuation, particularly for those working in hazardous occupation, it is important that at a minimum the letter encourages members to consider the consequences that switching funds may have on their insurance benefits.

It is also appropriate that the prescribed form of the mandatory member notice reflects the different consequences of failing a second consecutive test.

We remain concerned however a fund that is in the process of merging with a larger, high performing fund, cannot modify (or receive relief) to the prescribed wording in the underperformance notification to include information about the merger and explain what it means for the member.

Recommendation: When sending an 'underperformance letter' the fund should be able to include information about a proposed merger. Alternatively, funds that have agreed to a merger should potentially be able to receive an exemption from sending the letter, accordingly APRA should be given the powers to consider an exemption request on a case-by-case basis.

Recommendation: The consequences of failing to meet the proposed performance benchmark must be strengthened to protect disengaged existing members and avoid a new generation of members being left to languish in underperforming legacy products

Product coverage

Cbus supports the extension of the performance test to Trustee Directed Products but continue to be concerned that most of the Choice segment is not included in the performance test, despite repeated findings that this is where many of the worst member outcomes occur. Most recently, the 2023 APRA Choice Heatmap found that one in five Choice investment options significantly underperformed their benchmarks by more than 0.5% and over 40% underperformed against their benchmarks[2]. This is likely an underestimation given the heatmap only covers 47% of funds under management in the Choice accumulation sector and does not cover the retirement sector.

Recommendation: The amended performance test should apply to all superannuation products (including retirement products), as recommended by the Productivity Commission. Further consultation is required on how the performance test should apply to certain retirement products (such as longevity products)

[2] https://www.apra.gov.au/news-and-publications/apra-increases-transparency-of-choice-super-products-latest-heatmap