19 April 2024

Superannuation Efficientcy and
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Dear Sir / Madam

Annual Superannuation Performance Test-design options

Cbus welcomes the opportunity to contribute to the Government's consultation about the annual superannuation performance test.

The annual performance test serves as an important accountability mechanism and Cbus supports the role it plays in addressing underperformance within the superannuation sector. While we acknowledge the limitations of the current test, we believe it offers a reasonable assessment of a fund's success s in executing its investment strategy and in its three years of operation has led to improved member outcomes for members in underperforming MySuper products.

We supported the most recent enhancements that were made following consultation in 2023 and believe these changes addressed some fundamental flaws in the test, including extending testing assessment timeframes from eight to ten years to better reflect the long-term nature of super fund investments and theINA addition of further benchmarks such as emerging market equities.

The consultation paper considers four broad options in improving the operation of the test. Given each of the options have limitations and constraints, it is our view that that *Option 1 (Status Quo) – retaining current testing framework but improving it* represents the best option forward for both industry and members. Our submission provides some recommendations on the improvements that could be made to the current testing framework and our views on some of the other design options proposed by Treasury.

About Cbus

Cbus has the proud history of being one of Australia's first industry super funds, created in 1984 to assist in giving members a decent standard of living in retirement. Now in our fortieth year, Cbus has more than 910,000 members, managing over $85 billion of their money (as of 30 June 2023).

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.

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Option 1 (Status quo) – retain the current testing framework but improve it.

It is our preference that the current testing framework is retained and improved. The existing test has only been in place for MySuper products since 2021 and was recently expanded to trustee directed products (a small subset of Choice products) in 2023. In its short existence, the existing test has already improved member outcomes for many members that were in underperforming MySuper products.

In terms of an improvement that could be made to existing testing framework, Cbus believes that benchmarks ought not to be "unfrozen", as they can lead to retrospective adjustments and potentially shifting conclusions (i.e., a product may have just failed a performance test in a given year but was found to have just passed for that given year when the new unfrozen benchmark is applied). "Freezing" unlisted benchmarks at the end of each quarter also ensures consistency with most commonly used performance attribution systems.

It is also important to consider if the current infrastructure performance benchmark unintentionally constrains investments associated with the transition to a low-carbon economy. With the energy transition being an important issue, and superannuation funds having a potential role to play, the risk profile of the benchmark could be reviewed to ensure it does not limit funds' ability to invest in certain renewable energy projects that offer strong investment returns for members.

Whilst the current testing methodology is not without its limitations, we believe that significant changes to the testing methodology are not warranted, could cause further member confusion and that instead minor improvements could be made within the existing framework. We believe that any future changes should focus on extending the test so that all products are assessed, and all members receive the same level of protection from having their retirement balance being eroded due to being in an underperforming fund.

Option 2 – alternative single metric

As noted in the consultation paper, a limitation of the existing test is that it does not capture strategic asset allocation (SAA) decisions, which drive most returns over the long-term.

Introducing a simple reference portfolio (e.g., 70/30 growth/defensive split) could capture both implementation and SAA design effectiveness. This would better capture both implementation outcomes as well as strategic asset allocation design.

This simple reference portfolio could be applied to other types of Trustee Directed Products (e.g. "90/10" for High Growth options, "50/50" for Conservative Balanced type options). If Trustee Directed options were also bracketed into intuitive risk/return profiles, this would also likely assist consumer awareness and product comparisons.

However, in order for the naïve reference portfolio to be effective, APRA would likely need to take a supervisory role in overseeing which asset classes are treated as growth, defensive, or a hybrid of the two. This is notoriously difficult, as whilst some asset classes (e.g., listed equities and private equity) are objectively "growth" assets and some (e.g., government bonds and cash) are universally regarded as "defensive", many other asset classes genuinely feature both growth and defensive characteristics.

Whilst there is merit in an alternative single metric that considers SAA, it is our view that attempting to incorporate strategic asset allocation decisions would only further add complexity to the testing framework. Furthermore, we believe that any additional metric such as a simple reference portfolio should be in addition to the current test and not an alternative.

Option 3 – multi-metric framework.

A two-stage test which involves the current testing framework followed by a secondary risk-based assessment for failing funds could provide a more nuanced evaluation and better identify persistent underperformance. The secondary assessment could consider factors such as the fund's investment philosophy, governance structure, and any extenuating circumstances that may have impacted performance.

A current flaw of the existing test is that it relies on members actively switching out of underperforming funds and continues to risk that a new generation of members will be left languishing in underperforming legacy products – significantly impacting their retirement outcomes. These members can also continue to be 'stapled' to their underperforming fund when they change jobs. It is noted that the annual outcomes test recommended by the Productivity Commission recommended that an underperforming fund would have a 12-month window to address underperformance and if not possible would be withdrawn from the market.

Whilst there is merit in consideration of an additional test for funds which fail the current test, the addition of a two-stage test should be accompanied by stronger consequences for funds which fail both stages and better protect disengaged members that will not actively switch out of an underperforming fund.

Extending the test to other products

Given the number of Australians reaching retirement continues to increase over time – it is also important that the same level of protections which apply to accumulation products also apply to retirement phase products. We are concerned that most of the Choice segment (which includes much of the retirement segment) is still not included in the performance test, despite the Productivity Commission findings that this is where many of the worst member outcomes occur – with respect to investment underperformance. Given the size of member balances in retirement, a small difference in fees and returns can have a substantive impact – possibly more significant than during accumulation.

It is our view that the investment performance test should apply to all superannuation products (including retirement products), as recommended by the Productivity Commission. It is noted that the key purpose of the annual performance test is to protect members from significant and persistent underperformance and not as a measure to identify high performance or whether a product is the most suitable product for a member.

It is however noted that further consultation as to whether a performance test should apply to certain retirement products in which there is not an investment component (such as a longevity product). Whilst we acknowledge that retirement products are often more heterogeneous and customized to retirees' outcomes, there ought to be a level of underperformance in each product that is considered objectively unacceptable and treated as thus.

Conclusion
Cbus believes that the current annual performance testing framework has played a critical role in addressing underperformance in the MySuper sector in the three years since its introduction. Whilst the current test has its limitations (as do all the proposed options), we think it does a sufficient job in identifying underperformance and that wholesale changes to the test are not required and would not improve member outcomes.