JANA
DEPTH WITH DIFFERENCE

18 March 2021

Committee Secretary
The Senate Economics Legislation Committee
Senate Standing Committees on Economics
Department of the Senate
PO Box 6100
Parliament House
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To whom it may concern

Treasury Laws Amendment (Your Future, Your Super) Bill 2021 [Provisions]

Thank you for considering our response. Noting the preference for a focused response, this document focuses on the area which we believe we are most qualified to comment, being the "Addressing Underperformance in Superannuation" element of the Bill, specifically the performance test.

This submission covers the following:

- About JANA Investment Advisers
- Overarching comments
- Suggestions for improvement

About JANA Investment Advisers

JANA Investment Advisers was established in 1987 and today is one of Australia's leading and largest investment advisory and research firms with over 30 years of experience, ~110 staff and $600bn in funds under advice. Our firm is 55% owned by staff and 45% by the National Australia Bank Group.

JANA advises a wide range of clients covering superannuation funds, universities, foundations, endowments, charitable trusts, insurers, corporate clients, long service leave funds and family offices. JANA-advised clients have a history of outperforming both their own internal benchmarks and peers.

At JANA, we believe that together with our clients we can make a meaningful positive difference to the lives of millions of everyday people who are directly or indirectly impacted by the advice we provide. We are therefore very strongly aligned with the objective of increasing accountability for financial outcomes in superannuation and improving outcomes for members.

The Senate Economics Legislation Committee
Treasury Laws Amendment (Your Future, Your Super) Bill 2021 [Provisions]
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Overarching Comments in relation to the Provisions

Item 1: Inadequate detail in relation to the Performance Test set out in the Provisions

One of the key challenges in providing our response to the consultation is the lack of detail in the Provisions. Whilst the Your Future, Your Super Budget announcements in October set out a proposed performance test and consequences for failure, the Provisions and Explanatory Memorandum provided little detail relating to the mechanics and application of the performance test, with further and significant amounts of detail to be included in regulations yet to be provided and not part of this consultation. In addition, we believe how a test would apply to MySuper Lifecycle products requires more detailed consideration and we encourage policymakers to work closely with industry on the development of appropriate performance test metrics for Lifecycle products.

Given the proposed consequences for failure combined with most of the detail still to be provided in the regulations, we are of the view that the relatively short time horizon for planned implementation (1 July 2021 for the performance test to apply to MySuper products) is inadequate.

In light of the above, we are of the view that:

- The implementation of the "Addressing Underperformance in Superannuation" package should be deferred until 1 July 2022 to provide the industry adequate time to consider and consult on the significant detail to follow in yet to be drafted regulations. This would also allow time for policymakers to consider and consult on an appropriate performance test for lifecycle products, which make up a growing and large part of the MySuper universe. The October Budget-announced performance test is most easily applied to single strategy products and consideration needs to be given to how the performance test might apply to lifecycle products.
- The implementation of the "Addressing Underperformance in Superannuation" package for Choice multi-asset products (Trustee-directed products) is inherently more complex given the range of products and design specifications including SRI/ESG products and risk-managed products such as post-retirement, absolute return and lifecycle products. For reasons set out further in this Note, JANA does not believe it is necessary for a performance test to apply to Trustee-directed products where members have made an active choice to select a product. JANA is also cautious about the application of a single performance test for Trustee-directed products where there is no detail provided as to how performance tests would apply to this category of products (if at all). If there is the desire to apply a performance test to Trustee-directed products, we believe that implementation of any (as yet to be determined) performance test for Choice Trustee-directed products should be deferred to post 1 July 2023. This should include a reasonable lead time for consultation with the industry for both applicability of a performance test to Trustee-directed products and the specific details of how such a test would be applied.

Item 2: The proposed performance test is likely to be ineffective in many cases and is coupled with significant and disproportionate consequences for failure.

Whilst we are supportive of the Treasury's stated policy goals for the "Addressing Underperformance in Superannuation" element of the package, we are concerned that the proposed Performance Test set out in the Your Future, Your Super October Budget announcements is not sufficient in meeting the desired objective for the following reasons:

- By focusing on implementation only, the test only accounts for one aspect of performance measurement. In particular, the test is inconsistent with the well-established practice in the

Australian superannuation sector of setting a 'CPI plus' return objective, especially for MySuper and default products, reflecting the critical 'reason for being' of the system to provide real growth in members' retirement savings over the long term. The narrow focus of the test also means that other important measures of performance such as the effectiveness of asset allocation design, risk management and specific targets such as retirement outcomes, are not taken into consideration. We believe that a singular performance test provides a limited perspective for undertaking a robust performance assessment. The Treasury's proposed approach is contrary to accepted industry and academic practice of examining investment performance across a range of dimensions to derive a more complete assessment.

- The proposed performance test set out in the Budget has a material likelihood of being ineffective by failing to identify a poor fund as "poor", and by incorrectly classifying a good fund as "poor", resulting in undesirable outcomes for consumers who remain in poor funds, or worse, who move from a good fund to a poor fund. More detail for this assertion is set out in the Conexus working group paper documents which have been provided to Treasury and can be found here: https://theconexusinstitute.org.au/resources/your-future-your-super/. This working group comprised of senior representatives of consulting firms that consult to a significant proportion of the Australian institutional investment market (JANA, Frontier, Mercer, Rice Warner and Willis Towers Watson).

- The consequences for failing the test (i.e. closing a product to new members) is disproportionately large given the narrow focus of the single proposed performance test. There is a risk that a fund who has a decades-long track record of meeting the objectives promised to its members could fail the test, potentially creating a range of adverse outcomes for the fund and its members.

- Because of the significant consequences of failing the performance test, combined with the simple nature of the test, we are of the view that this will incentivise funds to actively manage the test. For example:
    - The use of shorting in listed equity mandates could result in these mandates being categorised as hedge funds which sit in 'alternatives' and would be assessed against a lower hurdle over the long-term (50/50 mix of blended equities and global fixed income).
    - Introducing higher risk, higher returning "alternative" or "credit" strategies into traditional defensive asset class portfolios with lower risk, lower returning benchmarks (such as the proposed benchmarks for the fixed interest and cash asset classes, the Bloomberg AusBond Composite 0+Y, Bloomberg Barclays Global-Aggregate Total Return Index Value Hedged ($A) and Bloomberg AusBond Bank Bill Index).
    - Deliberately setting a lower risk strategic asset allocation while consistently holding a higher risk, higher returning asset allocation. For example, a fund could include a 50% strategic asset allocation benchmark to equities and 30% to fixed interest but hold 60% in equities and 20% in fixed interest on an ongoing basis.

In the following pages, JANA has provided more detail in relation to the suggested improvements to the proposed test which we believe are objective and support the Treasury's desire for greater accountability and better outcomes for members.

Suggested Enhancements for Improving the Performance Test

Enhancement 1: Multiple performance tests

Performance measurement is inherently complex, and it is commonly accepted across the industry and academia that more than one single metric is required to develop a more complete appraisal of investment performance. This is also in line with the regulatory 'direction of travel' (outcomes assessment and Heatmaps) which use multiple metrics. We understand the appeal of a "single, simple" metric, but given the consequences of failing the test and the material chance of misjudging a good fund as "poor" and vice versa, the performance assessment needs to be more than "single and simple" - it must be fair and effective.

As discussed earlier, there are potential weaknesses to a single proposed performance test, and combined with the harsh consequences of failure, this might incentivise funds to actively manage (game) the test. For these reasons, we believe that ideally there should be more than one test. JANA is of the view that this is very attainable for single Default products and consistent with the objective of simplicity. In our view, a single performance test for MySuper Lifecycle products requires further consultation between industry and regulators.

For a single default product structure, we believe the approach could be enhanced by applying a set of tests that reflect a richer and more complete assessment of performance and this principle could equally apply to MySuper Lifecycle products in due course. The key principles/elements for enhancement are as follows:

- The application of additional simple, objective and rules-based tests, which would ideally include a suite of performance tests and fee/scale tests (e.g. similar to the current approach set out in the APRA Heatmap tests):
  - Multiple investment performance tests:
    - versus CPI plus objective (to tie back to retirement outcomes/objectives for members);
    - versus a SAA peer group (to provide an assessment of performance against a relevant "like for like" peer group);
    - versus a risk-adjusted metric (to assess performance relative to risk); and
    - versus a SAA benchmark portfolio (i.e. essentially the performance test which assesses implementation effectiveness).
  - Multiple fee / scale tests:
    - Investment fees, measured across a range of account balances/cohorts (say under 35, 36-45, 46-55, 56-65);
    - Administration fees, measured across a range of account balances/cohorts; and
    - Total fees, measured across a range of account balances (e.g. to include insurance).
- If policymakers wish to utilise only a single metric according to the proposal announced in the Budget, this approach could be enhanced by the process that is applied ***after*** failure of the single test, in particular through applying a subsequent set of tests such as those set out above.
- Failure of a majority of this suite of tests should result in the product being subject to restrictions, such as:

- Closing the product to new members and remedial oversight by APRA (or an Independent Review Panel) for three years or until the fund subsequently passes the majority of tests within three years.
- Where a product has been unable to pass the majority of subsequent tests within three years, APRA (or an Independent Review Panel) would have discretion to determine whether the product should continue (on the basis of evidence of improving performance) or be wound up, or compulsorily transferred to another Trustee.

Whilst we note that the inclusion of 'trustee-directed products' i.e. choice products, is subject to further regulations to be developed, in JANA's view, the proposed performance test set out in the October Budget does not lend itself well to assessing products that deliberately/naturally run a higher benchmark relative tracking error. This includes SRI/ESG products and risk-managed products such as post-retirement, absolute return and lifecycle products.

Further, if members actively choose these products, and given these products are still subject to the existing suite of regulatory measures and oversight (SPS530, SPS515, Heatmaps, etc), this is arguably sufficient. Under this model, the proposed performance test would apply solely to MySuper products (many members of which are inactive defaulted members) noting that further consultation is required for a performance test for lifecycle MySuper products. For choice products, we are of the view that the market should be able to innovate and develop products as it sees fit without the constraint of an ill-suited performance test, and thereby allow market forces (member active choice) to dictate winners, whilst at the same time being subject to existing regulatory frameworks.

Enhancement 2: 'Fit for purpose' benchmarks

JANA strongly encourages policymakers to consider incorporating unlisted asset class benchmarks into the performance test. We believe this would more closely align the performance test with the portfolio structures of most Australian superannuation funds. In particular, many funds hold significant allocations to unlisted assets including private equity, property, infrastructure and private debt. Including allocations to these unlisted investments assists in building well diversified portfolios, which is one of the requirements for a MySuper product. In addition, the ultra-low bond rates limit the effectiveness of bonds as a portfolio diversification tool, and on this basis, allocations to unlisted assets and equity-diversifying asset classes are important portfolio tools to support attainment of strong risk-adjusted returns for members.

While a single test is not JANA's preferred approach, we believe the incorporation of unlisted asset class benchmarks would alleviate some concerns from the industry that exposure to unlisted asset classes are penalised under the current approach. For example, there have been rolling 8-year rolling periods where unlisted property has materially underperformed listed property. As at 30 June 2007, we estimate that unlisted property underperformed listed property by ~5% p.a. over 8 years. Assuming a 10% weight to unlisted property and assuming no other active positions relative to the performance test methodology set out in the October Budget, this would likely result in a product being classified as "poor". Under this scenario, the product would be closed to new members, or worse, members leave the product to join a strongly performing fund (whose performance was "strong" on the basis of an exposure to listed property). Eight years later, as at 30 June 2015, we estimate that unlisted property outperformed listed property by ~7% p.a. All things being equal, this scenario would result in a poor outcome for members.

JANA has proposed a set of unlisted class benchmarks below for consideration. In addition, we have proposed an amendment to some of the listed benchmarks to reflect clarifications and what we believe to be more contemporary industry practice.

Asset Class	**Benchmark Name**	**Fee Assumption**	**Assumed Effective Tax Rates**
Australian Equity	S&P/ASX 300	0.05%	0%
Australian Private Equity	**Cambridge Australian Private Equity & Venture Capital Index**	**0%** **[Index is net of fees, expenses, and carried interest]**	**14%**
International Equities Unhedged	MSCI All Country World Ex-Australia Equities Index with Special Tax (unhedged in AUD)	0.11%	14%
International Equities Hedged	MSCI All Country World Ex-Australia Equities Index with Special Tax (100% hedged to AUD)	0.09%	14%
International Private Equity	**Cambridge Private Equity Index**	**0%** **[Index is net of fees, expenses, and carried interest]**	**14%**
Australian Fixed Interest	Bloomberg AusBond Composite 0+Y	0.10%	15%
International Fixed Interest	Bloomberg Barclays Global Aggregate Index (hedged in AUD)	0.10%	15%
Australian **Listed** Infrastructure	**FTSE Developed Core Infrastructure 50/50 Index Hedged in AUD Net Index Total Return**	0.26%	14%
International **Listed** Infrastructure			

Asset Class	Benchmark Name	Fee Assumption	Assumed Effective Tax Rates
Australian Unlisted Infrastructure	**CPI + 5% p.a. (refer to comments further below)**	**0% [assuming net returns]**	**14%**
International Unlisted Infrastructure			
Australian **Listed** Property	S&P/ASX 300 A-REIT Index	0.12%	14%
Australian Unlisted Property	**MSCI / Mercer Australian Wholesale Pooled Property Fund Index**	**0%** **[Index is net of fees, expenses, and carried interest]**	**14%**
International **Listed** Property	FTSE EPRA/NAREIT Developed ex Australia Rental Hedged AUD	0.22%	14%
International Unlisted Property	**NCREIF ODCE Index Hedged in AUD**	**0.75%**	**14%**
Australian Cash	Bloomberg AusBond Bank Bill Index	0.04%	15%
International Cash			
Other	25% International Equity Hedged	0.15%	14%
	25% International Equity Unhedged		
	50% International Fixed Interest		

Some points to note regarding our proposed indices for unlisted asset classes are:

- Some of the unlisted indices might have limitations in terms of availability or cost, but this is no different to the current proposed benchmarks.
- Some of the unlisted indices might have characteristics that may be materially different to the investments held by some funds, but this is no different to current proposed benchmarks, and in

any case unlisted indices will provide a better comparator than listed indices for these asset classes.

- For unlisted infrastructure, the universe of indices is limited in availability and underlying composition (sector or country). We would propose a simple CPI plus 5% p.a. measure since this reflects industry practice in objectives for unlisted infrastructure. If policymakers are keen to explore inclusion of an index for infrastructure, we would be pleased to share our views and analysis on the various indices and approaches to support a well-considered deliberation.
- While we have provided indicative tax rates and fee rates for these new proposed unlisted asset class benchmarks, these would require further analysis by policymakers.

Next Steps

Thank you for the opportunity to provide our feedback. We are more than happy to discuss further.

Regards

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