

A pathway forward for super funds and investment managers under the Your Future, Your Super performance test

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Introduction

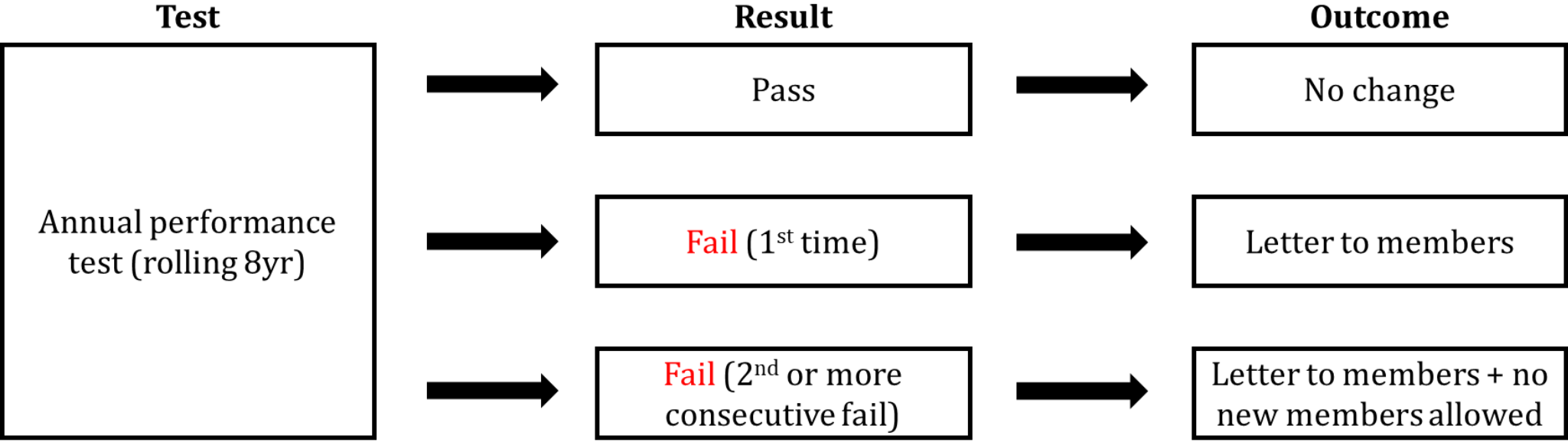
- A performance test included as part of the Your Future, Your Super (YFYS) reforms has proven controversial and disruptive
- This presentation considers the pathway forward for super funds and investment managers
- Full papers available:
 1. [Moving forward with YFYS: Super funds](#)
 2. [Moving forward with YFYS: Investment managers](#)

Background on YFYS

The YFYS reform package:

1. Addressing Underperformance in Superannuation: performance test
2. Single Default Account: “your super fund follows you through life”
3. Improving Accountability and Member Outcomes: range of measures

Background on YFYS Performance Test _____



Background on YFYS

Step 1 – Determine tailored performance test benchmark



Step 2 – Calculate annual performance (before admin fees)



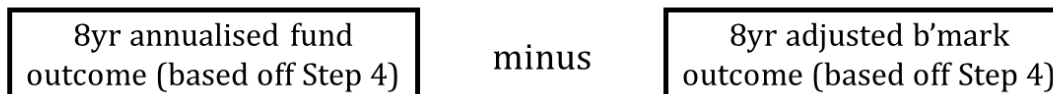
Step 3 – Calculate final year administration fees



Step 4 – Calculate annual total performance



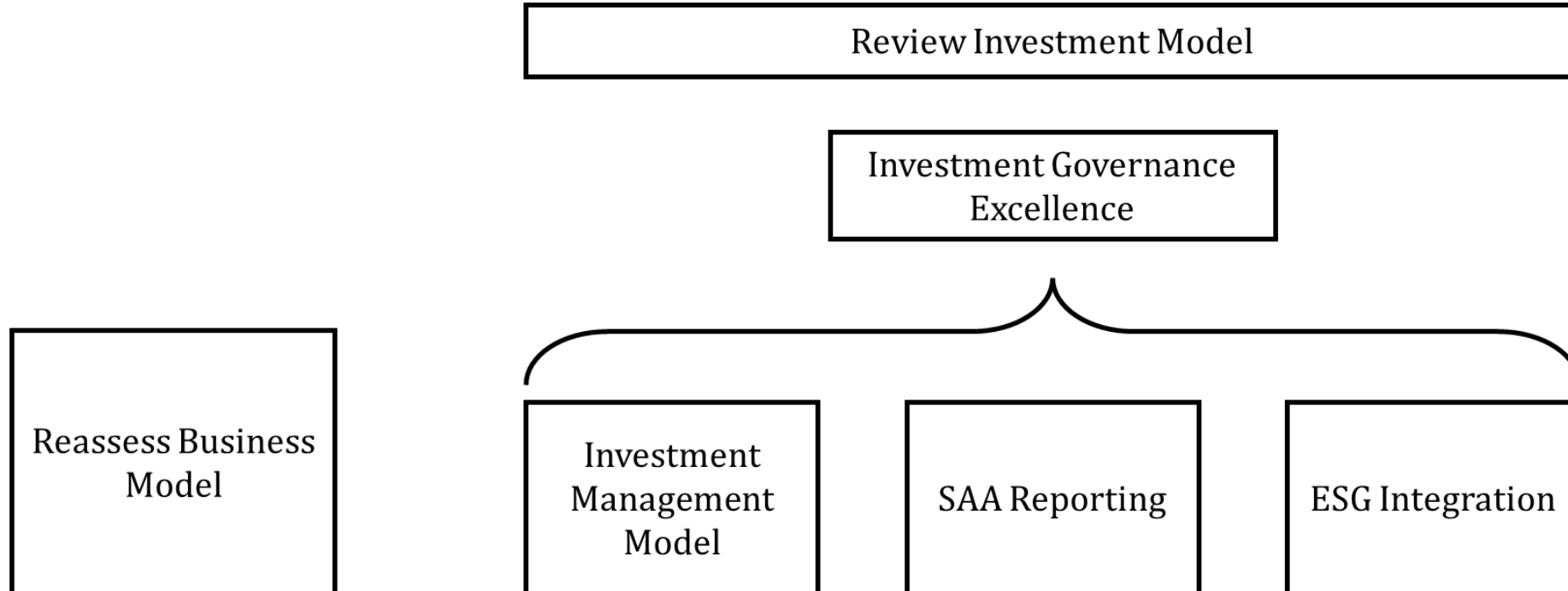
Step 5 – Calculate 8yr annualized performance test result



Additional notes:

- Test will be administered by APRA
- Pass mark is >-50bp pa

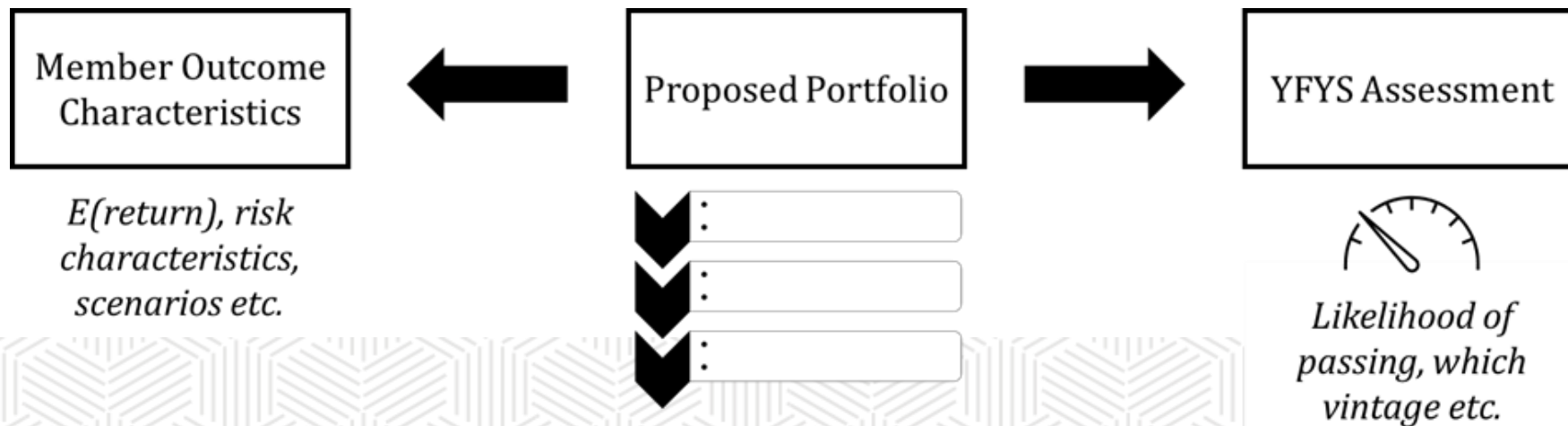
Adjustment period



Investment governance excellence

Standout characteristics:

- High-quality investment committee / board with practical and technical experience
- Strong working relationship between CIO and the governance structure
- Agreed tolerance for likelihood of failing the performance test
- Agreed framework for trading-off the maximisation of member outcomes against the likelihood of failing the performance test
- Ensure that activities not captured by YFYS performance test continue to be assessed and reviewed



Investment management model

1

Traditional SAA

- Universe: aligns with YFYS sectors and benchmarks.
- Implementation focus: controlled tracking error within sectors.
- Main portfolio management levers: implementation (moderate) and asset allocation decisions across sectors.
- YFYS-benchmarked, low tracking error and low-cost implementation strategies are likely to feature.

2

Advanced SAA

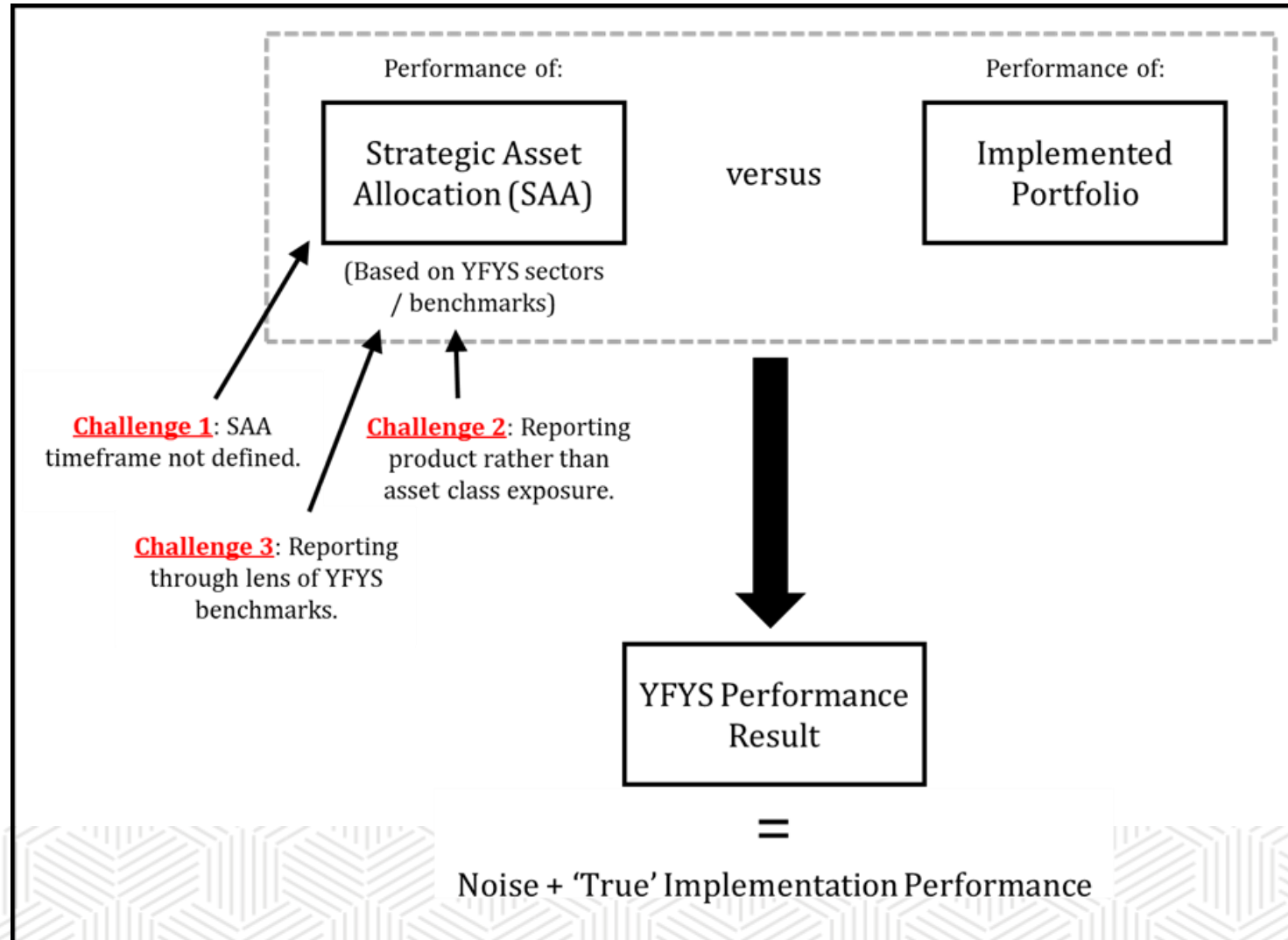
- Universe: broader than just YFYS sectors.
- Implementation focus: flexible, enabled by advanced operational and risk management which facilitates aggregated reporting on a YFYS basis (assets, scaled for YFYS benchmarks).
- Main portfolio management levers: asset allocation and implementation.

3

TPA

- Universe: unrestricted, managed at a portfolio level.
- Implementation focus: flexible, enabled by advanced operational and risk management which facilitates aggregated reporting on a YFYS basis (assets, scaled for YFYS benchmarks).
- Main portfolio management levers: integrated asset allocation and implementation.

SAA reporting



SAA reporting

Addressing the challenges:

- Challenge 1: shorter timeframe SAA, updated regularly, maybe other AA definitions
- Challenge 2: look-through SAA reporting (account for strategies such as alternatives)
- Challenge 3: risk-scaled SAA reporting (in 'units' of stated index exposures)

Managing portfolio risk

- Challenges:
 - Less diversification opportunities
 - Penalised for managing risk within sectors
 - Dedicated risk management strategies heavily penalized
- Solutions:
 - Potentially greater market timing

ESG / sustainability / climate risk

Impact Investing

- Assumed to be in private markets.
- Introduces significant tracking error into the portfolio.
- Potential for J-curve effect if unlisted.
- Likely to be small scale (if at all).

Opportunistic Investing

- Assumed to be in liquid markets.
- Introduces tracking error, but this can be measured and controlled.
- Likely to be small scale.

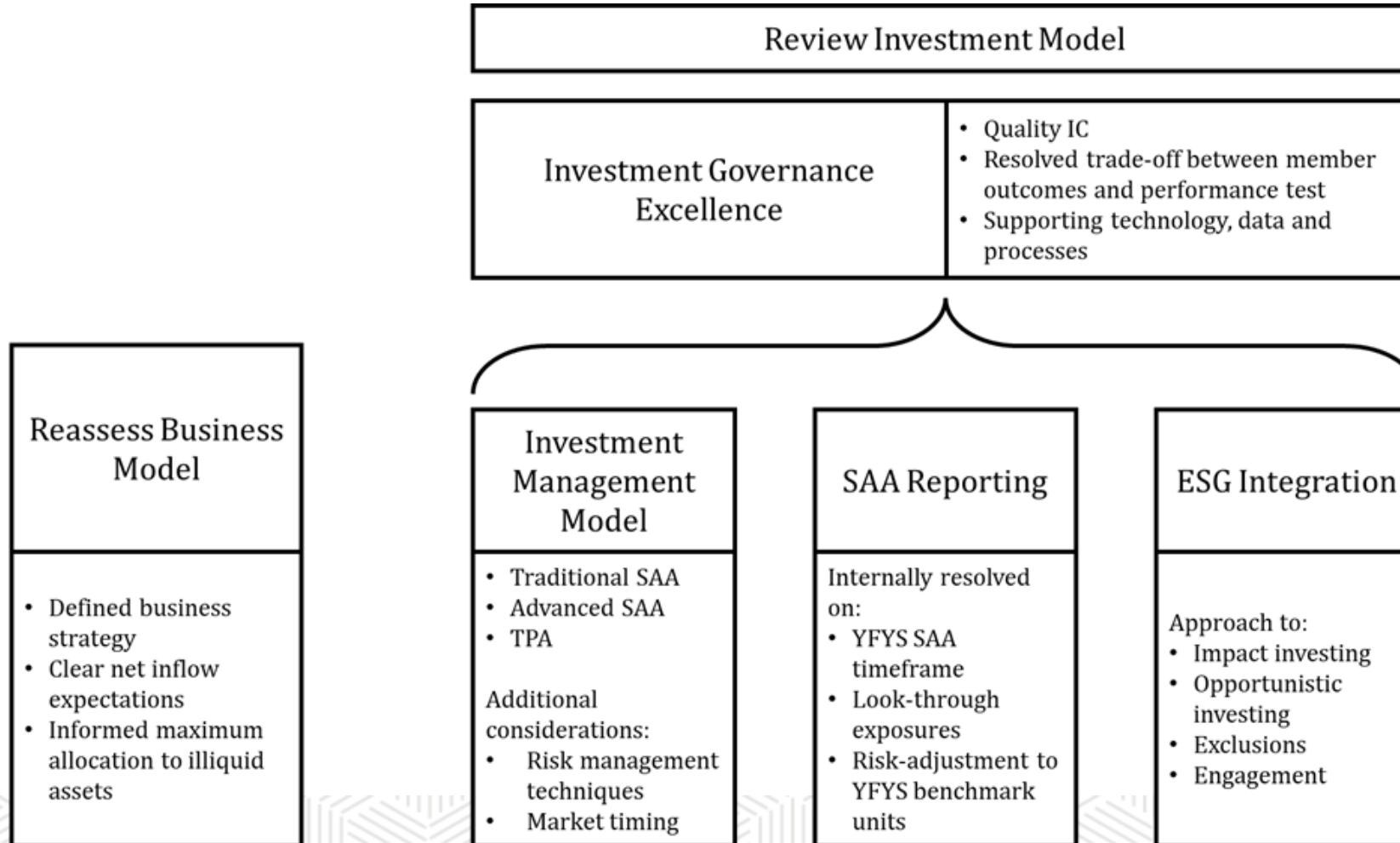
Exclusions

- Can introduce significant tracking error if applied in a coarse manner.
- Quantitative techniques can be applied to limit tracking error impact.
- Likely to remain a practice for small components of benchmark.

Engagement

- Supplement implemented investment strategy with a range of engagement strategies.
- Likely to remain commonplace.

The post-YFYS super fund



Impact on investment managers

Reassess business model

- Does your business model need to be revised given the impact of YFYS on super funds?

Active management

- The case for active management needs to be re-framed and stated strongly.

Understand your clients

- Understand your super fund clients through a YFYS performance test lens.

Opportunities

- There will be a range of opportunities for investment managers.

Considerations

From a business model perspective:

- Super funds: consolidation, internalization and fee pressure
- Super funds: reduced allocations to sectors which incur high tracking error against YFYS benchmarks

	Active Risk to Stated Benchmark	YFYS Benchmark Risk	Total Gross Risk (YFYS Benchmark)	Total Net Risk (YFYS Benchmark)
Active Large Caps	3%	0%	3%	3%
Active Small Caps	3%	6%	9%	6.7%

Summary

Super funds

- Significant challenges ahead and another 12 months for the “dust to settle”
- Consolidation a certainty
- Investment practices less clear

Investment managers

- Further challenges ahead and not all will survive

Welcome your questions and feedback ---

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