Responsible Investment Association Australasia

Submission

Review of Your Future, Your Super Measures

14 October 2022

Overview

The Responsible Investment Association Australasia (RIAA) thanks Treasury for the opportunity to comment on the review of the Your Future Your Super (YFYS) regime.

Overall, RIAA supports the intention of the legislation and enabling regulations to deliver stronger outcomes for superannuation members; however, a number of aspects of the regulations undermine the intent and effectiveness and run contrary to the need for superannuation funds to focus on long term challenges to delivering best outcomes for members.

RIAA's research, supported by other domestic and international research, consistently shows a growing demand for responsible investment, an investment approach that considers a broader array of risks and has been shown to contribute positively to strong risk adjusted returns (see for example RIAA's Responsible Investment Benchmark Report Australia 2021). Policy settings – including YFYS – should support funds to meet the growth in this demand, in a manner consistent with navigating long term investment risks, which will in turn support the Government's sustainability and economic objectives and help align capital with a more sustainable environment, society and economy.

It is important to ensure performance benchmarks are established in a manner that aligns superannuation funds to invest consistent with delivering strong, long term investment returns, aligned to the time horizons of their beneficiaries. Consideration should then ensure that benchmarks avoid deterring such a long term view, which we consider is an unintended outcome of the current structure of the performance tests. As it is currently operating, the performance tests risks undermining government priorities, including in relation to Australia's net zero trajectory.

Further data

RIAA has worked with Conexus Institute, London Stock Exchange Group and the Australian Sustainable Finance Initiative to undertake analysis on precisely how the consideration of various responsible investment approaches impacts on tracking error. This analysis is soon to be completed and will be provided shortly to Treasury. We commend Treasury to consider this as a key input to this consultation from RIAA. This work aims to test the tracking error likely produced from a range of scenarios, including:

- ESG portfolios implemented through exclusions
- Carbon transition portfolios
- Unlisted assets focused on carbon transition.

RIAA would be pleased to brief Treasury on the outcome of this together with Connexus Institute and other partners.

Response to consultation

Overall, RIAA supports the objective of the performance test to support members' financial interests, to protect consumers from underperforming funds, in a manner that ensures appropriate accountability and transparency. However, as currently designed, the test is having a major impact on market dynamics and is constraining investors' decision-making, including in ways that work against the long-term interests of members and the Government's climate and other policies.

Promotes a short term view:
There is evidence for example that superannuation funds are shortening their investment horizons in response to the performance test (Conexus Institute, July 2022, Assessing the impact of YFYS through interviews with CIOs of funds with performance 'buffer'). The test's failure to account for longer time horizons and the integration of responsible investment approaches into decision-making means that the longer-term risk context could be ignored or undervalued. Risks such as climate change and biodiversity loss are systematic and long-term and it is in the best financial interest of members to account for and address these risks particularly in light of the long time horizons of fund members.

Runs contrary to sound climate risk management:
The current performance test discourages investment approaches and products that are likely to provide stronger long-term returns for members over a horizon longer than the benchmark. Younger fund members will be retiring in the 2070s, so the benchmark as it is currently set acts against the interests of younger fund managers by measuring performance from a backward looking perspective and for a relatively short term time horizon.

It also inadvertently goes against the interests of those funds that are committed to net zero carbon emissions by 2050, in line with the Government's policy and legislation, by measuring performance against benchmarks that are not aligned to that 2050 trajectory. Consistent with our legislated climate targets, it would be appropriate for benchmarks to be aligned with these same Paris Agreement targets. Furthermore, there appears an inconsistency with backward looking performance tests whilst regulatory guidance, notably APRA guidance on managing climate change risks (CPG 229), stress the importance of managing for short and long term climate change risks.

Alternative approaches to benchmarking exist:

There are a number of examples of alternative benchmarks that support alignment to such long term targets and economic transitions, more appropriate for long term pension style investments. Some examples of such benchmarks that the government may wish to draw on in developing alternative benchmark for the Australian market are as follows:

- The European Commission's Paris Aligned Benchmark established in 2019 aims to reassign capital towards a climate resilient and low carbon economy. It involves:
    - 50% reduction in emissions compared to a fund's parent index in year 1
    - 7% year-on-year reduction of emissions relative to the fund itself
    - exclusions, such as "Do No Significant Harm", exclusion of tobacco, controversial weapons etc.
- The sovereign wealth fund of New Zealand, NZ Super Fund, has its own, bespoke, reference portfolio benchmark that allows NZ Super to consider the climate transition (in addition to its own particular model of asset allocation) – NZ Super recently moved around 40% of its overall portfolio ($25bn) to Paris-aligned indices.
- Private index providers have also developed many such appropriate forward looking benchmarks that better consider climate transition. such as FTSE Russell (LSEG) utilising a Paris-Aligned Benchmark based on the Transition Pathway Initiative (TPI) which measures how the world's largest and most

carbon exposed companies are managing the climate transition and applying index exclusions for companies that generate over 50% of revenue from environmentally sustainable activities and investments.

- In its submission to the Government's recent consultation on the Performance Test Treatment of Faith-based Products (July 2022), the Association of Superannuation Funds of Australia (ASFA) suggested that products could be assessed against a performance test that has been adjusted to take into account the particular filters/screens that the trustee has put in place.

Different approach for opt in, choice products:

In terms of product coverage, we believe that the test as currently constructed is not appropriate for Trustee Directed Products or other Choice Products, which is where we see a greater diversity of offerings of responsible investment approaches, and into which consumers are actively choosing to put their superannuation funds.

By not recognising the deliberate choice of consumers to follow a particular investment strategy, in many cases informed by their specific ethics or based on faith, the performance test may fail products that are in fact delivering on members' investment choices or consistent with their specific beliefs.

It is important to note that Choice Products are a diverse mix, and include single asset classes, and smaller ethical funds, and that any assessment of their performance should be understood in relation to the specific focus of the product, the objectives of the members, and the particular exclusions that could be a factor in driving a large tracking error.

YourSuper Comparison Tool:

We would also like to offer some insights from our consumer research that could help to improve engagement by consumers with the YourSuper tool.

We regularly undertake consumer research, to understand consumer preferences and expectations around the responsible and ethical considerations of their investments and super. We commend to you our research, as we believe it contains valuable insights to strengthen engagement: From Values to Riches Values to Riches: Charting consumer demand for responsible investment in Australia 2022.

Of note are the following insights:

- 83% of Australians expect their super and investments to be managed responsibly and ethically
- 61% of Australians would be motivated to save and invest more money if they knew their savings and investments made a positive difference in the world
- 81% of Australians believe their bank and super fund should pledge to achieve net zero emissions by 2050
- 75% of the population is more likely to invest in responsible investment products that have been certified or labelled as responsible by an independent third party.

Insofar as the objective of the YourSuper tool is to increase the engagement of consumers to make better informed decisions, this research indicates that these responsible and ethical investment issues are critical factors that could help to improve the information Australians want and need to more deeply engage with their investments, and elicit a stronger behavioural response.

We encourage consideration of these issues as additional elements that could increase engagement by Australians with their superannuation.

About RIAA and our members

RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand and is dedicated to ensuring capital is aligned with achieving a healthy society, environment and economy.

With over 500 members managing more than $29 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand. Our membership includes super funds, fund managers, banks, consultants, researchers, brokers, impact investors, property managers, trusts, foundations, faith-based groups, financial advisers and individuals.

RIAA achieves its mission through:

- providing a strong voice for responsible investors in the region, including influencing policy and regulation to support long-term responsible investment and sustainable capital markets;
- delivering tools for investors and consumers to better understand and navigate towards responsible investment products and advice, including running the world's first and longest-running fund Certification Program, and the online consumer tool Responsible Returns;
- supporting continuous improvement in responsible investment practice among members and the broader industry through education, benchmarking and promotion of best practice and innovation;
- acting as a hub for our members, the broader industry and stakeholders to build capacity, knowledge and collective impact; and
- being a trusted source of information about responsible investment.

We appreciate the opportunity to make this submission.

Simon O'Connor
CEO
Responsible Investment Association Australasia
simonoc@responsibleinvestment.org