

EXPOSURE DRAFT

EXPOSURE DRAFT EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer

Superannuation Industry (Supervision) Act 1993

Superannuation Industry (Supervision) Amendment (Your Future, Your Super – Addressing Underperformance in Superannuation) Regulations 2023

The *Superannuation Industry (Supervision) Act 1993* (the Act) governs the prudent management of superannuation funds and the supervision by the Australian Prudential Regulatory Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Commissioner of Taxation.

Section 353 of the Act allows the Governor-General to make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The purpose of *Superannuation Industry (Supervision) Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2023* (the Regulations) is to amend the *Superannuation Industry (Supervision) Regulations 1994* (the Principal Regulations) to address issues raised in Treasury’s review of Your Future, Your Super laws. The Regulations amend the testing period, benchmarks and notification letter that form part of the annual performance test requirements. Further minor technical updates to the regulations improve accuracy and clarity for the annual performance test, reduce the administrative burden for APRA and ensure the test is fit for purpose when it is extended to trustee directed products.

The *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (the YFYS Act) introduced an annual performance test for ‘Part 6A products’, which include MySuper products and other products as specified in regulations. The YFYS Act came into effect on 1 July 2021, with supporting regulations made on 5 August 2021. The performance test applied in relation to MySuper products on and after 1 July 2021 and will apply in relation to trustee-directed products on and after 1 July 2023.

The Act does not specify any conditions that need to be satisfied before the power to make the proposed Regulations may be exercised.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The Regulations commenced on the day after they were registered on the Federal Register of Legislation.

Details of the Regulations are set out in Attachment A.

The Office of Impact Analysis has been (OIA) has been consulted (OBPR22-03464) and agreed that the proposal is unlikely to have a more than minor regulatory impact, as changes are minor, provide further options or consequential. As such, the preparation of an Impact Analysis (IA) is not required.

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ATTACHMENT A

Details of the Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2023

Section 1 – Name of the Regulations

This section provides that the name of the Regulations is the *Superannuation Industry (Supervision) Amendment (Your Future, Your Super – Addressing Underperformance in Superannuation) Regulations 2023*.

Section 2 – Commencement

Schedule 1 to the Regulations commenced on the day after the instrument is registered on the Federal Register of Legislation.

Section 3 – Authority

The Regulations are made under the *Superannuation Industry (Supervision) Act 1993* (the Act).

Section 4 – Schedule

This section provides that each instrument that is specified in a Schedule to this instrument is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in the Schedule to this instrument has effect according to its terms.

Schedule 1 – Amendments to *Superannuation Industry (Supervision) Regulations 1994* (the Principal Regulations)

Items 20, 21 and 49 – 10 year lookback period

Items 20 and 21 amend the Principal Regulations to extend the lookback period of the performance test from eight to ten years. This means the performance test will now measure a Part 6A product's performance based on the past ten years of the product's performance history. The amended ten year lookback period will be applied prospectively as new data becomes available. Extending the lookback period is expected to sharpen the incentive of trustees to focus on long-term decision making and aligns with broader industry disclosures.

Item 49 is a consequential amendment to ensure the test period for the comparison rankings aligns with the extended lookback period.

Items 3 and 48 – Table of covered asset classes

Item 48 updates the table of covered asset classes with corresponding fee, tax and index assumptions under subregulation 9AB.17(7) of the Principal Regulations.

The purpose of the amendment is to improve the accuracy of the test, reduce the incentive for trustees to avoid certain investments, and reflect the latest index names, while maintaining the integrity of the test.

The table provides additional rows to disaggregate some covered asset classes which

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are now available to be used for the performance test as, under the new asset allocation standard, funds now have the choice to report more granular data. Disaggregated covered asset classes are provided for:

- International Equity (hedged; emerging markets)
- International Equity (hedged; developed markets)
- International Equity (unhedged; emerging markets)
- International Equity (unhedged; developed markets)
- Australian Fixed Income Excluding Credit
- Australian Credit
- International Fixed Income Excluding Credit
- International Credit
- Defensive Alternatives
- Growth Alternatives

The assumed index has also been updated for the following covered asset classes:

- International Unlisted Property has been updated to an index with a greater geographical allocation to international unlisted property assets.
- Australian and International Unlisted Infrastructure have been updated to a median version of the existing index to ensure that the benchmark remains representative of investments in these asset classes.
- Australian Fixed Income has been updated to include exposure to inflation linked bonds and floating rate credit.

Item 3 clarifies that assumed index has the meaning currently given in subregulation 9AB.17(7).

Item 53 – Trustee notification to beneficiaries

Under section 60E of the Act, trustees are required to notify beneficiaries if a Part 6A product fails the performance test. Subsection 60E(6) of the Act states that the notice from the trustee that a product has failed the performance test must be in the form and contain information of a kind specified in regulations. The notification form is set out in Schedule 2A of the Principal Regulations, and includes standard words explaining why the member has received the notice, and how poor performance of a superannuation product can negatively affect their retirement income.

Item 53 repeals Schedule 2A to the Principal Regulations and substitutes a new Schedule 2A with revised content for the notice. The revised notice content is intended to improve accessibility and effectiveness by using simpler language, and

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ensure the notice is fit for purpose of explaining what the result means for beneficiaries. The updated template letter includes tailored content to be used if a Part 6A products has failed the performance test two years in a row, and content specific to trustee-directed products.

Items 8, 9, 10, 11 and 12 – Meaning of trustee-directed products

The annual performance test applies for ‘Part 6A products’, which are defined in section 60B of the Act to be a MySuper product, or a class of beneficial interest in a regulated superannuation fund, if that class is identified by regulations.

Regulation 9AB.2 of the Principal Regulations includes a class known as ‘trustee-directed products’. APRA is required to conduct the first annual performance test for trustee-directed products by 31 August 2023.

Broadly, trustee-directed products are accumulation choice products with strategic asset allocations to more than one asset class where the trustee or a related entity has control over the design or implementation of the investment strategy of the product.

Item 8 inserts a definition of ‘trustee-directed product’ into regulation 9AB.1 of the Principal Regulations and defines the term as having the meaning given by regulation 9AB.2. This definition is necessary as the amendments made by the Regulations means that the term ‘trustee-directed product’ will appear throughout Division 9AB.

Item 9 repeals subregulation 9AB.2(1) of the Principal Regulations and substitutes a revised subregulation to improve readability. The operation of the subregulation is unchanged.

Item 10 repeals paragraph 9AB.2(2)(a) of the Principal Regulations and substitutes a revised paragraph to clarify the class of beneficial interests that fall within the scope of a ‘trustee directed product’. The intended operation of the subregulation is unchanged. It provides for the test to apply to products where at least one member is in the accumulation phase.

Item 12 provides rules to allow certain covered asset classes to be treated as one asset class for the purposes of working out whether a product is a trustee-directed product. This ensures that if a certain covered asset class is disaggregated, the same underlying product is consistently tested regardless of how it is reported to APRA. Item 11 makes a minor amendment to correct a reference of “Part 6A product” to the more specific “standard Part 6A product”.

Items 5, 7, 13 and 46 – Meaning of representative administration fees and expenses or RAFE

The Regulations do not substantively change the performance measure and its use of ‘representative administration fees and expenses’ or ‘RAFE’. A product’s ‘actual RAFE’ are the actual administration fees and expenses charged in the most recent financial year (as charged on a \$50,000 balance). ‘Benchmark RAFE’ is the median

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administration fee and expenses (as charged on a \$50,000 balance) across a certain category of products for the most recent financial year.

Item 7 repeals the definition of ‘representative administration fees and expenses’ or ‘RAFE’ in regulation 9AB.1 of the Principal Regulations and substitutes a new definition that provides that the term has the meaning given by regulation 9AB.4A.

Item 13 inserts regulation 9AB.4A which provides an updated definition of ‘RAFE’. The definition clarifies how RAFE is worked out for a Part 6A product, a Part 6A product that is a lifecycle Part 6A product, and a Part 6A product that is a trustee-directed product.

New subregulations 9AB.4A(3) to (6) clarify that the RAFE for a lifecycle Part 6A product is the lifestage that incurs the *largest* RAFE from the set of lifestage RAFEs. The purpose of the amendment is to ensure the Principal Regulations remain fit for purpose and provide certainty to trustees by explicitly stating in the law that it is the largest RAFE that is relevant to ‘actual RAFE’ and ‘benchmark RAFE’. Item 46 repeals subregulations 9AB.16(7) and (8) of the Principal Regulations which set out how to provide RAFE for lifecycle Part 6A products. These subregulations are no longer required as the rules are now provided for in the updated definition of RAFE.

New subregulations 9AB.4A(7) to (9) clarify that the RAFE for trustee-directed products is the standard fees and costs arrangement within each investment pathway and asset-weighted across investment pathways. Subregulation 9AB.4A(8) provides the rule for asset-weighting across an investment pathway in relation to a period. Asset-weighting by pathway provides an incentive for funds to reduce fees on the most popular pathways. Item 5 inserts a definition for ‘investment pathway’ to clarify that if there is a choice of different ways of investing in a Part 6A product, as reported to APRA in accordance with the applicable RSE structure standard, each of those ways is an investment pathway of the Part 6A product. Item 5 also inserts a definition of ‘investment pathway weight’, which has the meaning given by subregulation 9AB.4A.

The updated rule in new subregulation 9AB.4A(8) clarifies that RAFE is first worked out for each investment pathway for a quarter and then asset-weighted to get the RAFE for the quarter. The RAFE for four quarters in a year is then summed to produce the RAFE for a financial year. This ensures that RAFE remains fit for purpose when new investment pathways begin during a financial year.

Subregulation 9AB.4A(2) provides that in working out an amount for RAFE, assume that the amount related to a beneficiary of the entity with an account balance in respect of the Part 6A product of \$50,000 throughout the period. The purpose of this amendment is to ensure RAFE is calculated on the basis of a representative member. This does not change the way that RAFE is worked out, but makes it explicit in the Principal Regulations, which is necessary due to changes in APRA’s reporting standards. The \$50,000 balance is not affected by investment gains and losses.

Items 14 to 18, 35, 36, 39 and 40 – Meaning of strategic asset allocation or SAA

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Under the Principal Regulations the calculation for *strategic asset allocation or SAA* was set out separately for standard Part 6A products and lifecycle Part 6A products. The amendments place these rules together under regulation 9AB.5 of the Principal Regulations.

Items 14 to 18 consolidate and clarify how SAA is calculated for lifecycle Part 6A products, where the test will consider data reported at the lifestage level. This ensures that the test more accurately reflects the characteristics of lifecycle products, but does not substantively change the operation of the current law.

Items 35, 36, 39 and 40 make related consequential amendments and repeals.

Items 3 and 14 – Rules for determining ‘currency hedging ratio’

Regulation 9AB.5 of the Principal Regulations provides rules to work out strategic asset allocation where certain information about ‘asset domicile type’, ‘currency hedging ratio’ and/or ‘the ‘asset listing type’ is identified or not identified. Item 14 updates these rules to allow ‘strategic asset allocation’ to be worked out where information about ‘currency hedging ratio’ is not identified but option-level currency exposure is identified. Where currency exposure is identified, it can be used to impute a currency hedging ratio for the international asset classes.

The purpose of the amendment is to improve the accuracy of the test. The currency exposure can now be used for the performance test as, under the new asset allocation standard, funds now have the choice to report currency exposure at the investment option level instead of, or in addition to, currency hedging ratios for each asset class.

Item 3 inserts a definition of ‘currency exposure’ into regulation 9AB.1 of the Principal Regulations. ‘Currency exposure’ of a standard Part 6A product in relation to a quarter, means the Part 6A product’s currency exposure in relation to the quarter, as reported to APRA in accordance with the applicable asset allocation standard. ‘Currency exposure’ of a lifecycle Part 6A product in relation to a quarter, means the Part 6A product’s currency exposure in relation to the lifestage and the quarter, as reported to APRA in accordance with the applicable asset allocation standard. This difference is because lifecycle Part 6A products report currency hedging exposure at the lifestage level.

Items 5, 19, 34, 36, 38 and 40 – Meaning of index

Under the Principal Regulations the calculation for *index* was set out separately throughout Division 9AB. The amendments place the rules for calculating *index* under a new regulation 9AB.5A so that there is a single definition of the term for Part 6A.

Items 1, 5, 19, 47 and 48 – Alternative asset class

Item 47 amends the description of the covered asset class ‘Other/Commodities’ to ‘Alternatives’ to reflect the description of the covered asset class as it appears in the updated APRA reporting standard for asset allocation. Consequential amendments are

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made to correct references to this covered asset class description throughout Division 9AB.

Items 19 and 48 clarify the treatment of index assumptions for the Alternatives asset class. The amendments allow the consideration of data about the Alternatives covered asset class that can now be reported to APRA in an aggregated or disaggregated form, that is, reported as Growth Alternatives and Defensive Alternatives.

Item 19 also set out that for the Alternatives asset class, the index returns for the underlying asset class are first adjusted for fees and taxes using their corresponding fee and tax assumption and subsequently have a weighting applied. This provides for a more consistent calculation of the benchmark return for the Alternatives covered asset class by ensuring each assumed component is adjusted based on their relevant fee and tax assumption before aggregating.

Item 48 includes a consequential change to table item 24 in the table of covered asset classes under 9AB.17(7) of the Principal Regulations to reflect that after the adjustments in subregulations 9AB.13(7) and 9AB.14(7), the relevant assumed annual fee for the Alternatives asset class is 0% and the relevant assumed rate of tax for the Alternatives asset class is 0%. Table items 25 and 26 now reflect the disaggregated asset classes, Growth Alternatives and Defensive Alternatives.

Items 1 and 5 insert definitions of *adjusted index*, *IEH percentage*, *IEU percentage* and *IFI percentage* as these are all new terms required for the updated rules about the calculation of index for the Alternatives asset class.

Items 5, 23, 24, 26, and 27 – Definition of ‘NIR’

NIR is used to calculate the actual return part of the performance measure of a part 6A product. (9AB11 and 9AB12).

Item 5 inserts a definition of ‘gross investment return net of fees’, which is a variable for the new definition of NIR. Under the applicable investment performance standard, trustees are able to report ‘net investment return’ or ‘gross investment return net of fees’. ‘Net investment return’ is adjusted for tax whereas ‘gross investment return net of fees’ is not. Amendments are required to ensure an accurate and fair calculation of ‘NIR’ for both circumstances.

Item 23 repeals the definition of the variable ‘NIR’ in the formula for the calculation for ‘actual return’ for a standard Part 6A product in subregulation 9AB.11(2) of the Principal Regulations and substitutes a new definition. Item 24 inserts subregulation 9AB.11(3), which specifies the formula that derives NIR by adjusting the ‘gross investment return net of fees’ with an allowance for tax. The tax assumption is designed to mirror the tax assumption applied to the benchmark portfolio.

Similar amendments are made by items 26 and 27 to provide for an accurate and fair calculation of NIR for the formula for actual return for lifecycle Part 6A products in subregulation 9AB.12(2) of the Principal Regulations.

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Items 24 and 27 – Calculation of ‘actual return’ where a trustee-directed product has 2 or more net investment returns

Item 24 inserts subregulations 9AB.11(4) and (5) to provide rules for working out ‘actual return’ where a standard Part 6A product is a trustee-directed product that has two or more net investment returns in relation to at least one quarter in the lookback period. This can occur when the trustee-directed product has different net investment returns within an investment pathway or has multiple investment pathways.

The ‘actual return’ is found by first identifying the actual return for each investment pathway based on the standard fees and costs arrangement for each investment pathway. Next, the *smallest* of the actual returns across investment pathways is taken to be the ‘actual return’ for the Part 6A product. The investment pathway with the lowest NIR represents the pathway that incurs the highest investment fees. This incentivises funds to reduce investment fees on their highest fee pathways. An asset-weighted approach as undertaken for RAFE is not possible due to data limitations. Similar amendments are made by Item 27 to include the same rules for lifecycle Part 6A products.

Items 2, 4, 6 and 8 – Definitions of asset allocation standard, fees standard, investment performance standard, and RSE structure standard

Items 2, 4, and 6 repeal the definitions of ‘asset allocation standard’, ‘fees standard’, and ‘investment performance standard’ in regulation 9AB.1 of the Principal Regulations and substitute new definitions that incorporate new legislative instruments that were made in 2021.

Item 8 inserts a definition of ‘RSE structure standard’ to incorporate another two reporting standards made in 2021 under which trustees report information relevant for the performance test. The amendments provide clarity for trustees that APRA is allowed to use information collected under the new APRA reporting standards which have been determined by:

- *Financial Sector (Collection of Data) (reporting standard) determination No. 16 of 2021;*
- *Financial Sector (Collection of Data) (reporting standard) determination No. 17 of 2021;*
- *Financial Sector (Collection of Data) (reporting standard) determination No. 18 of 2021;*
- *Financial Sector (Collection of Data) (reporting standard) determination No. 20 of 2021; and*
- *Financial Sector (Collection of Data) (reporting standard) determination No. 21 of 2021; and*
- *Financial Sector (Collection of Data) (reporting standard) determination No. 22 of 2021.*

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APRA may use information collected under these legislative instruments and analogous past and future instruments. The Regulations incorporate the above legislative instruments as in force at the commencement on the instrument, and analogous legislative instruments (whether or not the legislative instrument is in force). The incorporated instruments, past, present and future, are freely and publicly available or will be available on the Federal Register of Legislation.

Items 28 to 32, and 41 to 45 – Intra-quarter data stitching APRA determination

The amendments allow APRA to make a general determination to combine part quarter data with other part quarter data for the calculation of ‘actual return’ in items 28 to 32, and for the calculation of ‘benchmark return’ in items 41 to 45. This allows the test to more accurately reflect products which change over time.

Consequential amendments are made throughout Division 9AB of the Principal Regulations to allow such a general determination to operate for relevant calculations for the performance test.

It is expected that APRA will make a general determination that will be made publicly available on the APRA website and the Federal Register of Legislation.

Items 19, 22, 25, 33, and 37– Rounding rules

Items 19, 22, 25, 33 and 37 update the rounding rules in Part 9AB of the Principal Regulations to ensure greater certainty and consistency. Certain calculation outputs must now be rounded to 10 decimal places instead of 4 decimal places. For certain calculation output that is eleven or more decimal places, the output should be rounded to 10 decimal places. This should be done by rounding up if the eleventh decimal place is a 5 or higher, or down if the eleventh decimal place is a 4 or lower. Where calculation output is 10 decimal places or lower, generally the rounding rules do not apply and the value should be inputted into the formula in full.

Items 50, 51 and 52 – Application and transitional provisions

Item 50 is a minor amendment to clarify that the transitional arrangements in Division 14.27 are the arrangements specifically arising out of to Schedule 1 to the *Superannuation Industry (Supervision) Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021*. This fixes a technical drafting issue where the original provision did not correctly specify the amending regulations.

Item 51 repeals a transitional provision that is no longer required as it was only applicable to the 2021 performance test, which has occurred.

Item 52 inserts a new Division 14.29 to the Principal Regulations to provide that the amendments made by these Regulations apply on and after 1 July 2023.