

EXPLANATORY STATEMENT

Issued by authority of the Treasurer

Superannuation Industry (Supervision) Act 1993

Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021

Section 353 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) provides that the Governor-General may 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 the *Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021* (the proposed Regulations) is to make amendments supporting the implementation of Schedule 2 to the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (the YFYS Act).

Schedule 2 to the YFYS Act amends the SIS Act to require the Australian Prudential Regulation Authority (APRA) to conduct an annual performance test for ‘Part 6A products’, which include MySuper products and other products if specified in regulations. A trustee providing such products will be required to give notice to its beneficiaries who hold a product that has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in regulations are satisfied.

The proposed Regulations include amendments that support implementation of Schedule 2 to the YFYS Act by specifying:

- when APRA must conduct the annual performance test, which products are subject to the annual performance test and the requirements for the annual performance test;
- the circumstances where products are to be treated as combined for the purposes of the amendments in the YFYS Act, such as the performance test and triggering the prohibition on a trustee from accepting new beneficiaries into an underperforming product;
- the form and content requirements for the notice a trustee is required to give to beneficiaries who hold a product that has failed the performance test;

- that an RSE licensee is required to make information about a failed annual performance test result in relation to a product it offers publicly available on its website;
- the circumstances where APRA may lift a prohibition on a trustee from accepting new beneficiaries into an underperforming product; and
- formulas as a basis for, or methods for, ranking Part 6A products, which under the amendments in the YFYS Act, APRA may give to the Australian Taxation Office (ATO) to enable the implementation of the YourSuper comparison tool announced by the Government as part of the Your Future, Your Super reforms.

The amendments relating to the new annual performance test and supporting implementation of the comparison tool apply in relation to MySuper products on and after 1 July 2021 and in relation to other classes of beneficial interest in a regulated superannuation fund specified in the regulations on and after 1 July 2022. The comparison tool will cover MySuper products.

The SIS Act specifies no conditions that need to be met before the power to make the proposed Regulations may be exercised.

The exposure draft Regulations and explanatory material were released for a four-week public consultation between 28 April and 25 May 2021.

Details of the proposed Regulations are set out in [Attachment A](#).

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

The proposed Regulations commence on the day after registration.

Regulation Impact Statement

The ‘Superannuation Reform—Your Future, Your Super’ measure announced in the 2020-21 Budget is estimated to have a total regulatory impact of \$5.1 million per year on business and individuals.

The Productivity Commission’s report, *Superannuation: Assessing Efficiency and Competitiveness*, has been certified as a process and analysis equivalent to a Regulation Impact Statement for the purposes of the Government decision to implement this measure. The report can be accessed through the Australian Parliament House website.

A statement of Compatibility with Human Rights is at Attachment B.

ATTACHMENT A

Details of the *Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021*

Section 1 – Name of the Proposed Regulations

This section provides that the name of the Regulations is the *Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021* (the proposed Regulations).

Section 2 – Commencement

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

Section 3 – Authority

The proposed Regulations are made under the SIS Act.

Section 4 – Schedule

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

Schedule 1 – Amendments

Background

The purpose of the proposed Regulations is to make amendments supporting the implementation of Schedule 2 to the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (the YFYS Act).

Schedule 2 to the YFYS Act amends the SIS Act to require APRA to conduct an annual performance test for ‘Part 6A products’, which include MySuper products and other products if specified in regulations. A trustee providing such products will be required to give notice to its beneficiaries who hold a product that has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in the regulations are

satisfied.

The proposed Regulations include amendments that support implementation of Schedule 2 to the YFYS Act by specifying:

- when APRA must conduct the annual performance test, which products are subject to the annual performance test and the requirements for the annual performance test;
- the circumstances where products are to be treated as combined for the purposes of the amendments in the YFYS Act, such as the performance test and triggering the prohibition on a trustee from accepting new beneficiaries into an underperforming product;
- the form and content requirements for the notice a trustee is required to give to beneficiaries who hold a product that has failed the performance test;
- that an RSE licensee is required to make information about a failed annual performance test result in relation to a product it offers publicly available on its website;
- the circumstances where APRA may lift a prohibition on a trustee from accepting new beneficiaries into an underperforming product; and
- formulas as a basis for, or methods for, ranking Part 6A products, which under the amendments in the YFYS Act, APRA may give to the ATO to enable the implementation of the YourSuper comparison tool announced by the Government as part of the Your Future, Your Super reforms.

Item 4 (proposed regulation 9AB.8 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regs) - When APRA must conduct the annual performance test

Under section 60C of the SIS Act, APRA must perform a performance assessment for every Part 6A product, in each financial year. Subsections 60C(2) to (4) state that APRA must make this assessment, determining if the product meets the requirements of the assessment and notify the trustee/s within a period given by the regulations after the end of each financial year of the outcome of the assessment and determination.

These proposed Regulations require APRA to make the determination and give the notification to the trustee/s before 1 September.

Items 1 and 4 (proposed subregulation 1.04(2), regulations 9AB.2, 9AB.6 and 9AB.10 of the SIS Regs) - Products that are subject to the annual performance test

Trustee-directed products

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

Broadly, trustee-directed products are products where the trustee has control over the design of the investment strategy of the product. The definition is designed to cover accumulation choice products where the trustee makes decisions regarding the product’s exposure to certain sectors and the underlying assets the product is invested in.

Products where the only control the trustee has over the product is to either offer or not offer the product to members are excluded from the definition of a trustee-directed product. These products include where the trustee offers a product where a third party manages the investment strategy for the member’s superannuation interest. This exclusion does not apply where the trustee is an associate of or has influence over the third party managing the interest or where the third party is acting as an agent of the trustee.

The amendments are also designed to exclude products that are single-sector investment options, where the member selects a product that mainly has exposure to only one type of asset class. Single-sector options are typically used in combination by a beneficiary in order to design their own bespoke diversified investment strategy. The amendments exclude single-sector investment options by requiring a trustee-directed product to contain at least two asset classes, where the strategic asset allocation for each of those classes must exceed 10 per cent.

For the purposes of working out whether a product is a single-sector investment option, a pair of asset classes is to be treated as combined to be one asset class if the description of each class is the same other than whether the class is hedged or unhedged. For example, a product with investments only in international equity hedged and international equity unhedged would not contain at least two asset classes, as these classes would be treated as combined. The amendments treat such a product as a single-sector investment option, excluded from being considered trustee-directed products.

The product must also not allow the member to direct the trustee to alter the amount invested in any particular class of asset. This ensures the trustee has the requisite control over the product for the performance test to be effective and meaningful.

Superannuation interests that are supporting a superannuation income stream in the retirement phase are not captured by this definition. These products have broader aims than accumulation products, which should primarily be focussed on investment performance.

Superannuation interests that are defined-benefit interests are not captured by the definition. For these types of interests, the product’s investment performance across the life of the interest does not directly impact the outcome for the beneficiary in

retirement. Generally this is due to the employer, rather than the beneficiaries, incurring the cost of underperformance in defined-benefit interests.

Other products offered by superannuation trustees where the benefit to the member is not contingent on the investment performance of the product are also excluded from the definition of a trustee-directed product. These products typically are contracts for insurance or products where the benefit is provided on the realisation of a particular risk.

See explanation of application provisions below for information about when the test will apply for trustee-directed products.

Products with certain number of years of performance history

The amendments specifying classes of Part 6A product for the purposes of section 60D(1) of the SIS Act (requirements for the product in relation to the financial year) ensure that products with less than 5 whole financial years of performance history are generally exempt from the performance test in the relevant financial year (unless APRA exercises discretion to subject these products to the test).

The number of years of a product's performance history (generally corresponding to a product's 'lookback period') is the number of financial years since the start of the first whole quarter for which a trustee has reported a 'net return' for the product up until (and including) 30 June of the financial year for which the annual performance assessment is conducted. The start of this period will not be the first part quarter for which net returns have been reported to APRA, as any quarter in which the superannuation fund was not, for the entire duration of the quarter, offering the product as potentially generating returns is to be disregarded. Any quarter where there was not at least one beneficiary holding the product will also be disregarded.

This approach strikes a balance between maximising coverage of the performance test and giving new products a chance to get established. The annual performance test is generally intended to assess a product's long-term investment performance.

APRA may exercise discretion to determine that a product with less than 5 whole financial years of performance history is to be subject to the performance test. In making such a determination, APRA must have regard to whether any other Part 6A products offered by the entity or an 'associated entity' (within the meaning of the *Corporations Act 2001*) have failed the performance test in any financial year. APRA could also consider any other features of the product or entity that would give rise to concerns regarding its likely future performance. For example, a product's fees, or the investment governance arrangements of the entity offering the product.

Allowing products with less than 5 whole financial years of performance history to be subject to the performance test at APRA's discretion also provides some scope for addressing avoidance behaviour where trustees have intentionally closed a product or opened a 'new' product in order to avoid being subjected to the performance test. APRA's determination is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*.

Items 3 and 4 (proposed regulations 4.01A, 9AB.3, 9AB.4, 9AB.5, 9AB.6, 9AB.9, 9AB.10 and 9AB.11 to 9AB.18 of the SIS Regs) - Requirements for annual performance test

Section 60D of the SIS Act allows regulations to specify the requirements that a product must meet to satisfy the annual performance test.

The requirements for the performance test are based on the methodology adopted by the Productivity Commission in its 2018 report, *Superannuation: Assessing Efficiency and Competitiveness*, and further refined by APRA in its Heatmap analysis, available on the APRA website. The test will:

- allow the performance of products to be compared easily as the performance benchmark will be tailored to each product's asset allocation;
- be customised to individual products and continue to provide funds with flexibility in constructing their investment portfolio;
- assess actual performance, net of fees and taxes; and
- be calculated over a time period that allows funds to target long-term returns, rather than having one or two years of poor performance result in a failure of the test.

The consideration of administration fees is designed to ensure that the results of the performance test are more reflective of the final outcomes for beneficiaries holding the product.

The methodology separates the infrastructure and property asset classes out into unlisted and listed assets. Unlisted asset classes can represent a different risk-return profile to their listed counterparts.

There are different requirements for standard Part 6A products and lifecycle Part 6A products. For the purposes of these amendments, a lifecycle Part 6A product is a Part 6A product where the supporting investments are divided into categories that are referable to a lifestage. A standard Part 6A product is a Part 6A product that is not a lifecycle Part 6A product.

In some cases, a product may have changed character in its lookback period (from a lifecycle Part 6A product to a standard Part 6A product or vice versa). In such a case, the amendments ensure the set of lifecycle formulas apply for the product for the product's entire lookback period. That is, if a product has been a lifecycle Part 6A product at any time in its lookback period, it will be in the lifecycle Part 6A product class.

In order to ensure the lifecycle formula works as intended for a product that has changed character, for certain quarters, the product will be treated as having one lifestage. See below for further information.

For all classes of Part 6A product (standard and lifecycle), the annual performance test is passed for a product if the product's 'actual return' minus its 'benchmark return', plus, its 'benchmark representative administration fees and expenses (or benchmark RAFE)' minus its actual administration fees and expenses (or actual RAFE)', (termed the product's 'performance measure'), is greater than or equal to -0.005 (which is equivalent to -0.5 percentage points).

A product's 'actual return' involves capturing the annualised net investment returns actually achieved by a product (over a certain performance period, termed the 'lookback period').

A product's 'benchmark return' involves the construction of an annualised benchmark net investment return that has been tailored for each product (and constructed over the same lookback period).

A product's 'actual RAFE' are the actual administration fees charged in the most recent financial year (as charged on a \$50,000 balance). 'Benchmark RAFE' is the median administration fee (as charged on a \$50,000 balance) across a certain category of products for the most recent financial year. This approach accounts for the current administration fees, which provides funds with a meaningful and timely avenue towards improving their test result.

In order to provide certainty and consistency, these amendments provide for rounding rules that apply for certain calculations used in the performance test. For certain calculation output that is 5 or more decimal places, the output should be rounded to 4 decimal places. This should be done by rounding up if the 5th decimal place is a 5 or higher, or down if the 5th decimal place is a 4 or lower. Where calculation output is 4 decimal places or lower, generally the rounding rules do not apply and the value should be inputted into the formula in full. There is a special rounding rule for one variable, which involves rounding down to the nearest whole number.

In order to provide certainty and consistency, these amendments require APRA to use information available to APRA on 15 August each financial year to conduct the performance test. APRA may make a determination that information available to APRA after 15 August and on or before 31 August be used for a specified product and financial year. APRA's determination is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. APRA must give a notice of the determination to the specified superannuation entity. The notice must be in writing and include a copy of the determination.

The amendments also specify that, for a Part 6A product that is a MySuper product or choice product, the product's result in the annual performance assessment is a benchmark that can be used to compare it and other MySuper products or choice products that are Part 6A products for the purposes of the trustee's annual outcomes assessment (see subparagraphs 52(9)(a)(i) and (ii) of the SIS Act). APRA will also be able to issue directions to an RSE licensee in relation to conducting the annual performance test for a product.

Requirements to satisfy the annual performance test (standard Part 6A products)

The amendments provide the formula for calculating ‘actual return’ for a standard Part 6A product.

The variables in the formula include ‘n’, ‘NIR’ and ‘t’.

The variable ‘n’ means the number of quarters in the lookback period, divided by 4 (which essentially captures the number of financial years, including part financial years in the lookback period, where part financial years are in units of quarters). For example, n could take the values 5, 5.25, 5.5, 5.75, which corresponds to 5 financial years, 5 financial years and 1 quarter, 5 financial years and 2 quarters and 5 financial years and 3 quarters respectively.

Generally, the ‘lookback period’ for a Part 6A product in respect of a financial year means the period that starts on the start of the first whole quarter for which a trustee has reported a ‘net investment return’ for the product to APRA and ends on 30 June of the financial year for which the assessment is made. In determining the first whole quarter, any quarter in which the superannuation fund was not offering the product as potentially generating returns for the entire duration of the quarter, or any quarter where there was not at least one beneficiary holding the product, is disregarded. Generally, this means a product's lookback period will include the number of financial years (including part financial years) for which there is data for the product, counting back from the financial year for which the performance assessment is made.

However, the rules are designed such that the lookback period for a Part 6A product will not include more than 8 financial years of performance history, counting backwards from the 30 June in the financial year for which the assessment is made. A transitional rule is provided for the first performance assessment, which is conducted for the financial year 2020-21, such that a maximum of 7 financial years of performance history is included in the lookback period. This aligns the lookback period with available APRA data.

The variable ‘t’ represents a quarter in a consecutive sequence of quarters, where if $t=1$, the quarter is the first quarter that starts in the lookback period.

The variable ‘NIR’ in relation to a quarter has the same meaning as in the *Financial Sector (Collection of Data) (reporting standard) determination No. 40 of 2015* or an analogous legislative instrument that was in force in the past or that is made in the future to replace that instrument. Such instruments are defined as the ‘investment performance standard’ in the proposed Regulations. ‘NIR’ is reported to APRA on a quarterly basis. The proposed Regulations incorporate the *Financial Sector (Collection of Data) (reporting standard) determination No. 40 of 2015* as in force at the commencement of the instrument, and analogous past and future instruments. The amendments in subsection 60D(13) of the SIS Act ensure that despite subsection 14(2) of the *Legislation Act 2003*, regulations may apply, adopt or incorporate, with or without modification, any matter contained in an instrument as in force or existing from time to time. The incorporated determinations, past, present and future, are freely and publicly available or will be available on the Federal Register of Legislation.

The proposed Regulations provide the formula for calculating the ‘benchmark return’

for a standard Part 6A product.

The variables in the formula include 'n' and 't', which have the same meaning as in the formula for calculating the 'actual return' (see above).

It is necessary to refer to a table of covered asset classes with corresponding fee, tax and index assumptions (inserted by the proposed Regulations) in order to derive or unpack the other variables and components of the formula. The table inserted by the proposed Regulations covers the assumptions that apply for the quarters starting on or after 1 July 2014, which corresponds to the first quarter included in the lookback period for products with 8 or more financial years of performance history, as of 1 July 2021.

The variable 'a' represents a 'covered asset class', which can be identified in the table of assumptions by its description. For example, if $a=2$, then 'a' represents the covered asset class in item 2 of the table, which is International Equity (hedged). The variable 'A' means the number of covered asset classes in the table for the quarter. At this point in time, 'A' is equal to 16 in every case, as there are 16 items in the table for quarters starting on or after 1 July 2014. Future amendments to the table of assumptions could add additional asset classes for different quarters, in which case 'A' may take on a different value.

The variable 'SAA' generally means the product's strategic asset allocation. 'Strategic asset allocation' is the benchmark asset allocation value reported to APRA through the *Financial Sector (Collection of Data) (reporting standard) determination No. 13 of 2015* or an analogous legislative instrument that was in force in the past or that is made in the future to replace that instrument. Such instruments are defined as the 'asset allocation standard' in the proposed Regulations. 'SAA' is reported to APRA on a quarterly basis. The proposed Regulations incorporate the *Financial Sector (Collection of Data) (reporting standard) determination No. 13 of 2015* as in force at the commencement of the instrument, and analogous past and future instruments. The incorporated determinations, past, present and future, are freely and publicly available or will be available on the Federal Register of Legislation.

For a given quarter t, the value of 'SAA' used in the formula will be the value as at the end of quarter t-1 (that is, the value reported to APRA for the preceding quarter). In other words, $SAA_{a,t-1}$ represents the strategic allocation for a given asset class heading into t.

However, for a product that is first established in quarter t, there may be no value of 'SAA' at the end of quarter t-1. In such a case, the value of 'SAA' used in the formula will be the value at the end of quarter t (rather than the value in t-1).

The amendments clarify that in other cases where the product does not have a strategic asset allocation in respect of a covered asset class (set out in the table of assumptions) for a quarter, 'SAA' in respect of the covered asset class for the quarter is zero.

The proposed regulations provide rules that apply 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. The amendments ensure that in cases where it is not possible to work out the product's strategic asset allocation to a particular covered asset class in relation to a quarter, due to data being insufficiently granular and where this cannot be resolved under the provided rules, APRA may make a determination to resolve the problem. ARPA's determination is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. APRA must give a notice of the determination to the specified superannuation entity. The notice must be in writing and include a copy of the determination.

The variables in the formula also include 'index', 'fee' and 'ART' which represent for a particular covered asset class for a quarter, a benchmark return for the covered asset class to be calculated using the index formula inputting data derived by reference to an index assumption, the assumed annual fee, and assumed rate of tax, respectively.

The relevant assumed annual fee and assumed rate of tax for a particular covered asset class for a quarter can be found in the last two columns in the table of assumptions.

In order to work out the 'index' (that is, the benchmark return for the covered asset class), generally the relevant assumed index for the asset class must be identified from the table of assumptions, which sets out the index name and its Bloomberg ticker or unique identifier. For the table items relating to infrastructure and property unlisted asset classes, there is no applicable ticker code. The index name and ticker (if available) will enable the information necessary to compute the benchmark return for the covered asset class (or 'index') to be identified. For example, some index values could be found on the Bloomberg terminal.

The table of assumptions is set out in the proposed Regulations to provide certainty, transparency and consistency in the performance test that funds will be subject to. It is anticipated that the table will be updated for future assumption changes, containing a complete record of the assumptions for past quarters in one place.

However, there may be a need for APRA to make a legislative instrument to deal with material changes in the interim before new regulations are made updating the relevant assumptions.

Paragraph 60D(7)(c) of the SIS Act allows regulations to be made specifying conditions to be met before APRA can make a legislative instrument specifying alternative assumptions (than those set out in the table in the regulations). Different conditions apply if the assumption relates to fees or taxes, as compared to the conditions that apply if the assumption relates to an index.

In relation to providing a different fee or tax assumption, these amendments provide that all of the following conditions be met:

- APRA consult with the Treasurer before making such a legislative instrument; and
- APRA must be reasonably satisfied that as a result of material changes in the investment environment, the assumed fee or assumed rate of tax specified in

the table is no longer suitable in relation to that quarter.

In relation to providing a different index assumption, these amendments provide that all of the following conditions be met:

- APRA consult with the Treasurer before making such a legislative instrument;
- APRA must be reasonably satisfied that the assumed index specified in the table does or did not exist in relation to a particular quarter; and
- APRA must be reasonably satisfied that the alternative index is one that is substantially analogous to the existing index specified in the table.

Where a product is comprised of investments in a class of assets that meet the description ‘Other/Commodities’ (which has the same meaning as in the ‘asset allocation standard’), the class of assets is treated as falling into the last item of the table. The assumed annual fee and assumed rate of tax for this category of assets are 0.10 per cent and 14.50 per cent, respectively. These figures have been calculated using a weighted average of the fee and tax assumptions from the ‘International Equity (hedged)’, ‘International Equity (unhedged)’ and the ‘International Fixed Interest’ covered asset classes, where the weights are 25 per cent, 25 per cent and 50 per cent respectively. For example, the fee of 0.10 per cent was computed by taking the sum of the following:

- 0.25 multiplied by the assumed annual fee for International Equity (hedged);
- 0.25 multiplied by the assumed annual fee for International Equity (unhedged); and
- 0.50 multiplied by the assumed annual fee for International Fixed Interest.

The proposed Regulations also include rules to ensure that in applying the formula for benchmark return, the ‘index’ for the ‘Other/Commodities category’ covered asset class and a given quarter is calculated by taking the weighted-average of the indices for that quarter for the same asset classes as above, using the same weights as above.

For the ‘Australian Unlisted Infrastructure’ and ‘International Unlisted Infrastructure’ covered asset classes, in some circumstances, a different assumed index will apply to that specified for those covered asset classes in the table of assumptions. Those circumstances are where the index value for those covered asset classes for the last quarter in the lookback period for Part 6A products is not publicly available within 36 days after the end of the financial year for which the performance test is conducted. In such circumstances, the regulations provide that the assumed index for ‘Australian Listed Infrastructure’ is instead to be used in relation to the final 2 quarters in the lookback period for the product (noting that the values in the final 2 quarters are needed to calculate the ‘index’ for the final quarter in the lookback period). This ensures that where there is a delay in the release of applicable data, the regulations provide an alternative assumption that is to be used instead, allowing APRA to conduct the performance test by 1 September each year.

Requirements to satisfy the annual performance test (lifecycle Part 6A products)

The proposed Regulations provide the formula for calculating the ‘actual return’ for a lifecycle Part 6A product.

The variables in the formula include ‘n’ and ‘t’, which have the same meaning as in the formula for calculating the ‘actual return’ for a standard Part 6A product (see above).

Consistent with the definition for a standard Part 6A product, the variable ‘NIR’ for a particular quarter and lifestage is also defined by reference to the *Financial Sector (Collection of Data) (reporting standard) determination No. 40 of 2015*. See above for further information.

The variable ‘J’ means the number of lifestages in the Part 6A product. The variable ‘j’ represents a lifestage of the Part 6A product, in a consecutive sequence of lifestages, where if $j=1$, the lifestage is the lifestage that applies to the youngest beneficiaries who hold the product. It is possible for a lifecycle product to be structured such that there is more than one lifestage for a given set of beneficiary age characteristics. For example, a lifecycle product could have two sub-lifestages by superannuation balance, such as two groups of 40-50 year olds, one group with low balance and one group with high balance. In such a situation, APRA may determine the order for the sub-lifestages in the consecutive sequence. This matter is provided for by APRA determination to allow a consecutive sequence of lifestages to be defined without needing to include in-built assumptions about how lifecycle products are designed beyond being based on age characteristics. The order of the lifestages in the sequence does not impact on the results from the calculation and as such APRA’s determination for these purposes will not affect the interests of any person. APRA’s determination is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*. APRA must give a notice of the determination to the specified superannuation entity. The notice must be in writing and include a copy of the determination.

The ‘lifestage weight’ variable provides an asset-based weighting for each lifestage. The weights are determined by the market value of investments referable to each lifestage as a proportion of the market value of all investments supporting the lifecycle Part 6A product. These market values are reported to APRA quarterly.

For a given quarter, the market value will be the value as at the end of the previous quarter (that is, the value heading into a given quarter). However, for a product that is first established in a given quarter, there may be no market value at the end of the previous quarter. In such a case, the market values to be used in working out the ‘lifestage weight’ for the lifestage will be the value at the end of the given quarter (rather than the value at the end of the previous quarter).

The proposed Regulations provide the formula for calculating the ‘benchmark return’ for a lifecycle Part 6A product.

The variables in the formula include ‘n’, ‘t’, ‘j’, ‘J’, and ‘lifestage weight’ which have the same meaning as in the formula for calculating the ‘actual return’ for a lifecycle

Part 6A product. See above.

The variables in the formula also include ‘a’, ‘A’, ‘ART’, ‘fee’, ‘index’, and ‘SAA’, which have the same meaning as in the formula for calculating the ‘benchmark return’ for a standard Part 6A product. See above.

In some cases, a product may have changed character in its lookback period (from a lifecycle Part 6A product to a standard Part 6A product or vice versa). In such a case, the amendments ensure the set of lifecycle formulas apply for the product for the product’s entire lookback period. That is, if a product has been a lifecycle Part 6A product at any time in its lookback period, it will be in the lifecycle Part 6A product class.

Where a product changes character during a quarter, APRA may make a determination for that particular product and the quarter during which the product changed character, to modify the formula for a benchmark return for a lifecycle Part 6A product. APRA may specify modifications that APRA considers reasonably necessary to reflect the circumstances of the change in character during a quarter. In such a case, the amendments ensure the information that applies for the part quarter before the change and the part quarter after the change may be taken into account. APRA must give a notice of the determination to the specified superannuation entity. The notice must be in writing and include a copy of the determination.

In order to ensure the lifecycle formula works as intended for a product that has changed character, for certain quarters, the product will be treated as having one lifestage. Generally, the quarters subject to this rule (one lifestage quarter) will be those following a quarter (the previous quarter) in which the product was reported to APRA as a standard product. However, a one lifestage quarter may also be the first quarter in relation to which net returns are reported for the product (the initial quarter) to overcome issues with there not being (or not being enough reported data in relation to) a previous quarter. Where APRA has made a determination to modify the formula for benchmark return for a quarter during which the product changed character, that particular quarter cannot be a one lifestage quarter (as for part of that quarter, it is appropriate that APRA treat the product as having more than one lifestage).

This means that when interpreting aspects of the lifecycle formula that require a calculation to be repeated for all lifestages and the sum of those results to be calculated, the calculation is just done once for the one lifestage. This will also mean that for those quarters, the ‘lifestage weight’ will be equal to one, as for a product with only one lifestage, the numerator and denominator in the definition of ‘lifestage weight’ will be equal. As a number multiplied by one is equal to the original number, this ensures that when applying the lifecycle formula, effectively there is no lifestage weight being applied.

Items 4 and 6 – (proposed regulation 9AB.19 and Schedule 2A of the SIS Regs) - Form and content requirements for trustee notification to beneficiaries

If APRA has determined a Part 6A product has failed the performance test, APRA

will notify the trustee of the entity that offers the product. Section 60E of the SIS Act requires the trustee of the entity to provide a notice to each beneficiary of the entity who holds the product, within 28 days of APRA giving notice of the assessment, that the product has failed the performance test.

Subsection 60E(5) of the SIS Act provides that notices must be provided by post to the beneficiary's last known address, and via email to each beneficiary's email address (if there is a nominated email address).

Subsection 60E(6) of the SIS Act states that the notice must be in the form and contain information of a kind specified in regulations. These amendments set out the standard words and forms that are to be used by trustees when informing beneficiaries of a failed performance test.

The standard words and forms of the beneficiary notification ensure that notice of underperformance is presented to all beneficiaries in a consistent, clear, concise and effective manner.

All beneficiary notifications must explain to the member that their superannuation product has performed poorly, and that the member should consider moving their interest into a different product. The notification gives details of the test applied to determine the product's underperformance, and also provides beneficiaries with information on how to change to a superannuation product that may perform better than the current product they hold. The notification also directs beneficiaries to the YourSuper comparison tool for information on products that have met the requirements of the performance test.

The notification includes standard words covering questions and answers on why the member has received the notification, and how poor performance of a superannuation product can negatively affect their retirement income.

Item 2 (proposed paragraph 2.38(2)(ea) of the SIS Regs) - Requirement for RSE licensee to make information about fail test result publicly available

Paragraph 29QB(1)(b) of the SIS Act allows regulations to prescribe information or documents that a RSE licensee must ensure is made publicly available and kept up to date on the RSE's website. This regulation making power supports the existing list of information and documents prescribed in subregulation 2.38(2) of the SIS Regs.

Where a product does not pass the performance test for the first time, the RSE licensee must ensure that a description of the circumstances is made available on the RSE's publicly available website. The RSE licensee must also take this step where the product has failed the performance test previously, but it is not the product's second consecutive failure, in which case the product is closed to new members.

The purpose of this requirement is to warn prospective beneficiaries when a product (which remains open) has been assessed as underperforming in the latest financial year. There is no need for this information to be published on the website if the product is closed to new beneficiaries (as a consequence of two consecutive fails) as

there cannot be prospective beneficiaries to warn because the product is closed to new members.

Item 4 (proposed regulation 9AB.20 of the SIS Regs) - APRA determination to lift prohibition

Section 60F of the SIS Act allows regulations to specify the requirements that a product must meet for APRA to be allowed to make a determination to lift the prohibition from accepting new beneficiaries into products.

These amendments provide that APRA may make a determination for a product to reopen to accept new beneficiaries, if the product passes the annual performance test in a subsequent financial year. The requirements for the annual performance test are described above.

Item 4 (proposed regulation 9AB.7 of the SIS Regs) - Circumstances where products treated as combined

Section 60G of the SIS Act allows regulations to specify one or more kinds of circumstances that multiple Part 6A products may be treated as combined. Specified kinds of circumstances may allow for multiple Part 6A products to be treated as being one Part 6A product;

- treating anything that happened in relation to a single Part 6A product as having happened in relation to the combined Part 6A product; and
- treating a person who holds a single Part 6A product as holding the combined Part 6A product.

Section 60G of the SIS Act also allows regulations to specify matters that APRA must take into account in exercising its discretion to make a declaration that products are to be treated as combined.

The amendments provide that if APRA considers that making a determination is appropriate in the circumstances, APRA may make a determination in writing that 2 or more specified Part 6A products offered by one or more specified regulated superannuation funds should be treated as combined. APRA must give a notice of the determination to each trustee of the regulated superannuation funds specified in the determination. The notice must be in writing and include a copy of the determination.

The purpose of this is to allow the performance test to be appropriately applied in a range of situations where products should be assessed together, including circumstances where trustees have intentionally closed a product or opened a new but similar product in order to bypass the consequences of failing one or more performance tests.

If products are treated as a combined product or the performance history of one product is attributed to another product, a product may be found to have failed the

performance test, or failed the performance test in two consecutive years. As a consequence a Part 6A product may be prohibited from accepting new beneficiaries.

APRA's determination is not a legislative instrument within the meaning of subsection 8(1) of the *Legislation Act 2003*.

Item 4 (proposed regulations 9AB.21 to 9AB.25 and Division 9AB.3 of the SIS Regs) - Amendments to support implementation of YourSuper comparison tool

The YourSuper comparison tool will be available on an interactive website designed to make it easy for beneficiaries to choose a superannuation product based on fees and performance information.

Section 60J of the SIS Act allows regulations to specify formulas and methods by which Part 6A products can be comparatively ranked, and allows APRA to pass the information necessary for ranking products on to the ATO to publish on a website maintained by the Commissioner of Taxation. The YFYS Act provides that the ATO must publish this information to the extent that it relates to Part 6A products that are MySuper products. Whilst the proposed Regulations made for this purpose provide transparency about the basis on which superannuation products will be ranked on the YourSuper website, the proposed Regulations do not prescribe the specific layout and design of the website.

The proposed Regulations allow Part 6A products, including lifestages of products that are lifecycle products, to be ranked in the prescribed ways. It is intended that initially only MySuper products will be ranked. These products are the default product for most members, and therefore most common type of superannuation interest. As MySuper products are also generally held by the most disengaged members, it is therefore important that comparing products is easy, clear and intuitive so that MySuper product holders can see if their product is meeting their needs.

Part 6A products should be ranked according to two methods. First, products should be ranked by net returns. Ranking products by net returns will allow members to assess the return their investment is generating in comparison to the returns of other products. Second, products are ranked by total annual fees. Using this method, members are able to see the fees charged by their superannuation fund in comparison to other products managed by other superannuation funds. This comparison will allow members to make informed judgements on the value of the fees that they pay and promote competition between superannuation funds.

When products are ranked according to the two methods articulated above, the information for each product will include the result of the most recent performance test with products that passed the test ranked separately to products that failed the test. For lifestages of lifecycle products, the result of the most recent performance test will be the result for the whole lifecycle product. Members will be able to clearly differentiate between those products that are performing and those that are underperforming.

The information necessary for the rankings is reported to APRA under the *Financial*

Sector (Collection of Data) (reporting standard) determination No. 41 of 2015. The proposed Regulations incorporate this instrument as in force at the commencement of the instrument, and analogous past and future instruments. Such instruments are defined as the ‘fees standard’ in the proposed Regulations. The incorporated determinations, past, present and future, are freely and publicly available or will be available on the Federal Register of Legislation.

Item 4 (proposed regulation 9AB.1 and Part 9AB of the SIS Regs) - Consequential amendments

The proposed Regulations insert a new Part 9AB of the SIS Regs, setting out the requirements for the annual performance test and amendments supporting the implementation of the YourSuper comparison tool.

Consequential amendments are made to insert relevant headings and an interpretation provision for the new Part, containing supporting definitions.

Item 5 (proposed regulation 14.28 and Division 14.27 of the SIS Regs) - Application and transitional rules

The amendments insert a new Division 14.28 of the SIS Regs to deal with application and transitional rules.

The amendments relating to the new annual performance test and supporting implementation of the comparison tool apply in relation to MySuper products on and after 1 July 2021 and in relation trustee-directed products on and after 1 July 2022. The YourSuper comparison tool will cover MySuper products.

A transitional rule is provided for the first performance assessment, which is conducted for the financial year 2020-21, such that the lookback period will commence no earlier than the 1 July that is 6 years before 1 July 2020 (being 1 July 2014). This means a maximum of 7 financial years of performance history is included in the lookback period. This aligns the lookback period with available APRA data.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Insert Title of Regulation

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The purpose of the *Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021* (the proposed Regulations) is to make amendments supporting the implementation of Schedule 2 to the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (the YFYS Act).

Schedule 2 to the YFYS Act amends the SIS Act to require the Australian Prudential Regulation Authority (APRA) to conduct an annual performance test for ‘Part 6A products’, which include MySuper products and other products if specified in regulations. A trustee providing such products will be required to give notice to its beneficiaries who hold a product that has failed the performance test. Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product. APRA may lift the prohibition if circumstances specified in regulations are satisfied.

The proposed Regulations include amendments that support implementation of Schedule 2 to the YFYS Act by specifying:

- when APRA must conduct the annual performance test, which products are subject to the annual performance test and the requirements for the annual performance test;
- the circumstances where products are to be treated as combined for the purposes of the amendments in the YFYS Act, such as the performance test and triggering the prohibition on a trustee from accepting new beneficiaries into an underperforming product;
- the form and content requirements for the notice a trustee is required to give to beneficiaries who hold a product that has failed the performance test;
- that an RSE licensee is required to make information about a failed annual

performance test result in relation to a product it offers publicly available on its website;

- the circumstances where APRA may lift a prohibition on a trustee from accepting new beneficiaries into an underperforming product; and
- formulas as a basis for, or methods for, ranking Part 6A products, which under the amendments in the YFYS Act, APRA may give to the Australian Taxation Office (ATO) to enable the implementation of the YourSuper comparison tool announced by the Government as part of the Your Future, Your Super reforms.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.