

Media Release

SYDNEY March 3, 2021

The Government's Your Super, Your Future performance test will have unintended negative consequences on the investment strategies of many super funds, according to a working group that has released the first research detailing the impact of the test.

The research, authored by David Bell, executive director of independent, not-for-profit Conexus Institute, was reviewed by investment industry researchers from Frontier, JANA, Mercer, Rice Warner, and Willis Towers Watson. Full details of the working group are provided in Addendum 1.

The research, all open source ([here](#)), demonstrates that if trustees of super funds designed portfolios to explicitly account for the YFYS performance test, many funds would need to significantly alter their investment strategy.

The results of this research highlight the conflict trustees will face between managing for best member outcomes and prioritising the YFYS performance test.

"If trustees continue with their current investment strategy, they expose themselves to a reasonable likelihood of failing the performance test at some point, simply through the short-term randomness of returns" said Bell. "These trustees would also face the prospect of having to modify their investment strategy in response to short-term performance, creating transaction costs while inadvertently reducing their ability to invest for the long-term."

Bell is concerned about the unintended consequences of the performance test.

"Trustees may find that portfolios designed to pass the YFYS performance test have lower expected returns, are less effectively diversified, and bear more risks than portfolios constructed purely in the best interests of members."

The research also finds that the benefits of 'banked performance' (whereby a fund with strong past performance doesn't have to concern itself with the YFYS performance test) are short-lived.

"The rolling annual nature of the performance test means that each year generates a new performance series. Hence, the performance test will impact all super funds".

Case study: impact on private market allocations

The research details a case study of a super fund designing an investment strategy intended to be stable and have high likelihood of passing the performance test. According to the research such a fund would need to significantly reduce its allocation to unlisted assets from the current industry average.

The research shows such a fund would need to limit its total exposure to areas such as unlisted property and unlisted infrastructure to around 10%. Many super funds currently allocate more than 20% of their portfolios to these sectors.

Bell believes the performance test design needs to be improved.

"The YFYS performance test is well-intended but the design requires improvement. The intention of the test can be achieved without many of the adverse impacts created by the present design. Some well-considered modifications would have a large positive impact."

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Addendum 1

Working group members.

	Affiliation
David Bell	The Conexus Institute
Kim Bowater	Frontier
David Carruthers	Frontier
Matthew Griffith	JANA
Emily Barlow	Mercer
Clayton Sills	Mercer
Andrew Boal	Rice Warner
Nick Callil	Willis Towers Watson
Tim Unger	Willis Towers Watson

About the Conexus Institute

Established as an independent, philanthropically funded think tank designed to be a catalyst for positive change to Australia's retirement system, The Conexus Institute adopts a research-for-impact model. Much of its work involves collaborating with industry and academia while the Institute presents itself as an unbiased sounding board resource for regulators and policymakers.

Notable pieces of work over the last year included growth / defensive asset categorisation, research on portfolios with illiquid assets, analysis of the Your Future, Your Super performance test and involvement in the UNSW Sandbox Program. Research is generally made open source and can be accessed at the [Conexus Institute website](#).

The priorities for this year will be to continue to focus on the Your Future, Your Super reforms, complete work on growth / defensive categorisation and the governance of portfolios with illiquid assets, before shifting the focus to financial guidance and retirement solution design.