

Market Insights

February 2022

**The heat is on –
superannuation fund
performance in 2021**



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Frontier's purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.



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Paul joined Frontier in 2019 and provides investment advice to a range of clients and is part of the Capital Markets and Asset Allocation Team. Prior to joining Frontier, Paul worked as a Performance Analyst in the Performance and Risk Analytics division at National Australia Bank, he started his career as a fund accountant at Apex Fund Services (Australia) Pty Ltd. Paul graduated with a Bachelor of Commerce (Accounting and Finance) from the University of Melbourne and Paul is a Chartered Accountant and a Chartered Financial Analyst.



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David joined Frontier in 2015 and leads the Members Solutions Group. He provides investment advice to a range of clients and conducts research in the area of retirement strategy and product development for superannuation funds. Prior to Frontier David spent 19 years at Mercer in both the UK and Australia and Towers Perrin for around six years, working with a number of clients in a consulting and research capacity. David holds a Bachelor of Economics from Macquarie University and is a Fellow of the Institute of Actuaries of Australia.

INTRODUCTION

The heat is on – superannuation fund performance in 2021

Last year will forever be remembered for the introduction of the Your Future, Your Super (YFYS) annual performance test. Love it or hate it (and most industry commentators are in the latter camp), the test is here to stay.

The inaugural MySuper performance test identified 13 products which were rated a 'fail'. These products accounted for 6% of total MySuper assets.

In anticipation of the release of the YFYS performance for certain Choice products in June 2022, APRA released the MySuper and Choice Heatmaps during December 2021.

In this paper we analyse how well a 'pass/fail' grade in these tests translates to actual member outcomes.

Performance test results

Eradicating unacceptable product performance and improving transparency across the superannuation industry are APRA's worthy aims to achieving better member outcomes.

APRA's objectives in releasing these Heatmaps are:

- Heighten transparency to hold trustees accountable
- Provide comparable measures of performance across products
- Promote industry consolidation to drive better outcomes.

Table 1: Summary of performance test results

	Pass	Fail
MySuper YFYS ¹	67 products 13m member accounts \$844b assets 94% of assets	13 products 1m member accounts \$56b assets 6% of assets
Choice Heatmap	297 products 71% of options	101 products 29% of options

Source: Frontier, APRA data. 1. MySuper YFYS statistics are based off the APRA dashboard published on 31 August 2021.

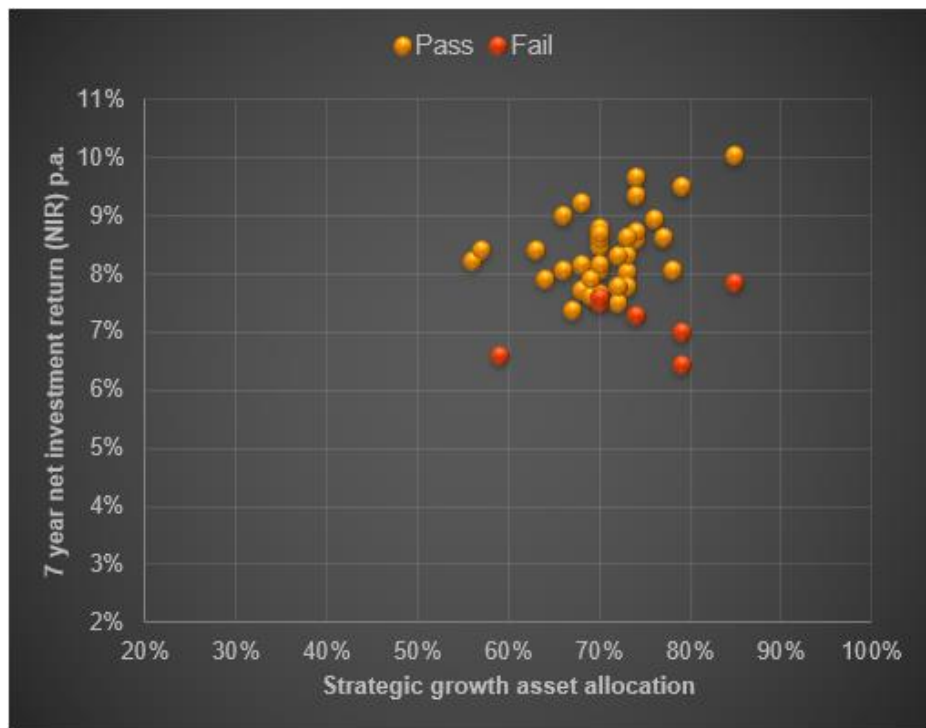
It is important to note while the MySuper YFYS analysis included all available funds (excluding Asgard, BOC and VISSF which failed the test and have since closed), the Choice Heatmap results were less extensive. The APRA Choice Heatmap results only included multi-asset funds based on available data from SuperRatings (some funds do not participate in these surveys). This accounted for less than 25% of the total non-MySuper assets.

MySuper YFYS results

The charts below plot the seven-year net investment return for each MySuper (single strategy and lifecycle) option versus the APRA-defined growth ratio.

Chart 1 displays the results for single strategy MySuper defaults – seven of these options failed the YFYS performance test. The results in this chart shows funds which failed, have produced lower net investment returns for a given amount of growth asset allocation compared to funds which have passed.

Chart 1: Single strategy options

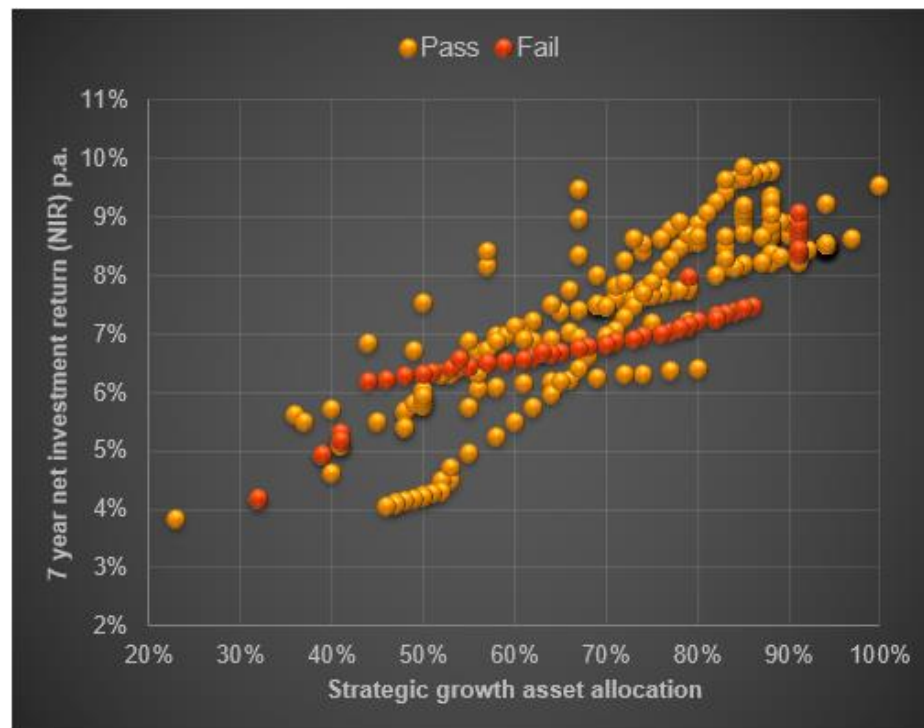


Source: Frontier, APRA data

Chart 2 displays the results for each option of the MySuper lifecycle products. Some lifecycle products only have a few stages, while others have a stage for each age. The 'pass/fail' designation is a weighted average (FUM based) of each stage's result.

Many of the failed product options have displayed better returns than the passed products for a similar level of strategic growth asset allocation. Older members in certain passed products could achieve a better investment outcome if they were invested in the failed products.

Chart 2: Lifecycle options



Source: Frontier, APRA data

MySuper three and five year APRA Heatmap results

This chart plots the relative performance of each single strategy option over the three- and five-year periods (excluding administration fees).

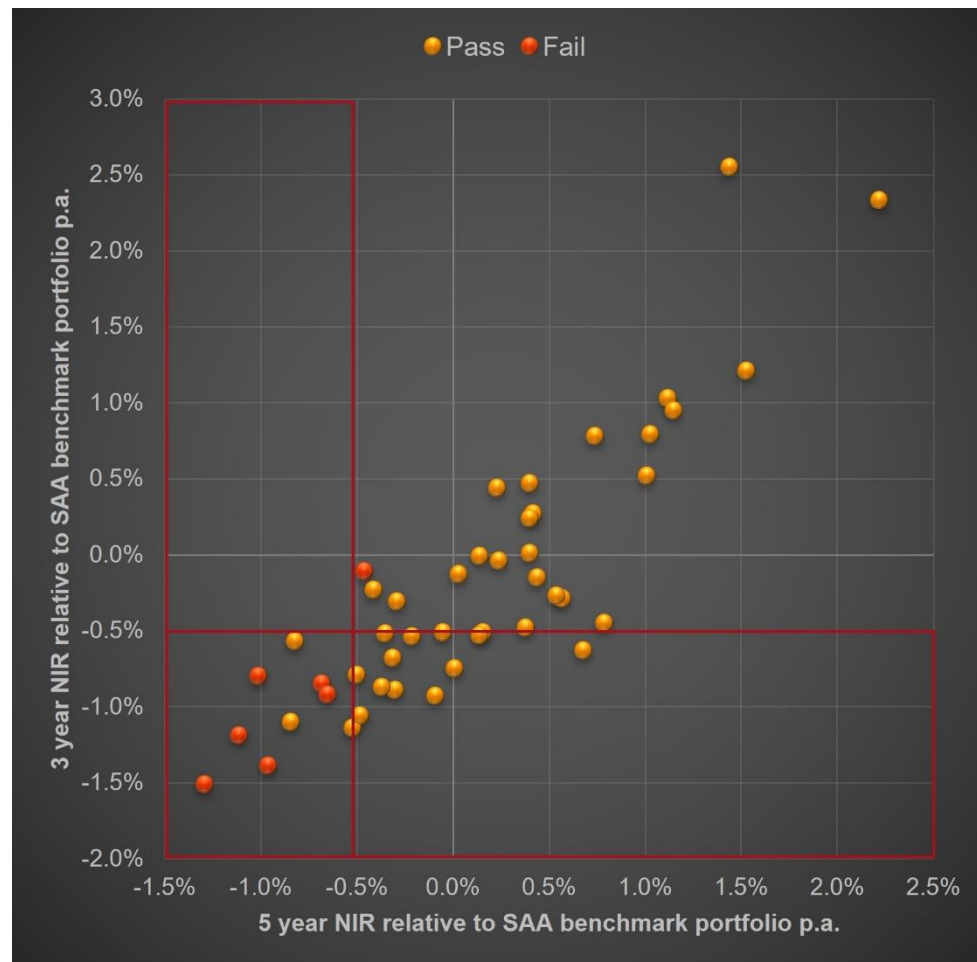
The chart highlights most of the funds (six out of seven) which received a 'fail' grade over seven years are also below the -0.50% performance threshold over the three- and five-year periods. Only one 'fail' option over the seven-year period is not in the 'fail' quadrant over the three- and five-year periods.

Another observation is there are significantly more funds below the underperformance threshold over the three-year period. This highlights the importance of assessing investment performance over longer time horizons, as short-term horizons could introduce more 'noise' into the calculations. In particular, the cyclical nature of manager alpha (especially recently in equity markets) will have a short-term affect on the results.

There are 17 additional funds whose performance is below the -0.5% performance threshold when compared to their listed SAA benchmark over three years. These funds' official seven-year YFYS performances are above the threshold. This may indicate the possibility of these funds experiencing YFYS performance test issues in future years.

Over the five-year period, there are an additional four options that have exhibited relative performances that are below the -0.50% performance threshold.

Chart 3: Three- and five-year performance to June 2021¹



Source: Frontier, APRA data.

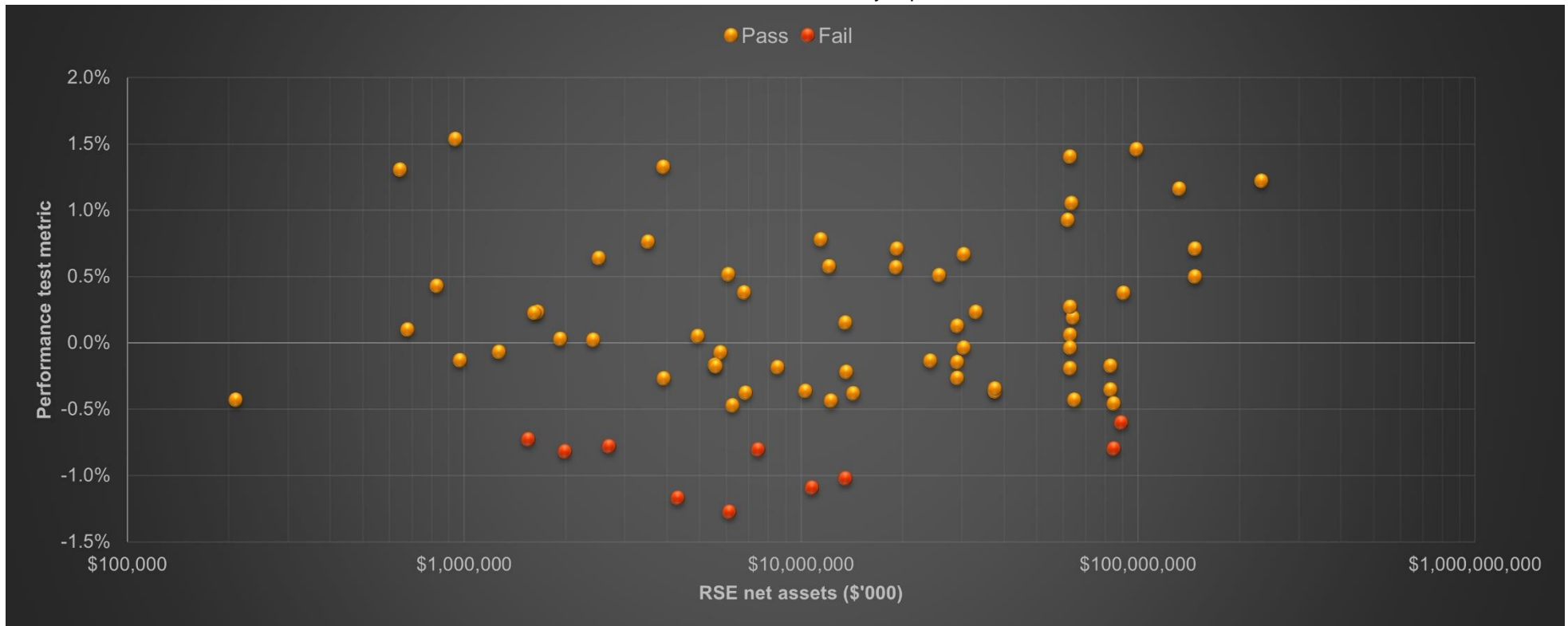
1. The relative performance is calculated relative to each option's listed SAA benchmark and excludes administration fees.

MySuper YFYS performance relative to total fund size

One of APRA's stated aims is to drive consolidation. The premise is larger funds are in a stronger position to provide better outcomes for members.

The chart below compares the MySuper YFYS results with the total assets of the fund. The results show there is no significant relationship between asset size and YFYS outcome. The funds which failed the YFYS performance test range from very large to medium sized. Similarly, the funds which underperformed the test but not below the -0.50% level are also evenly split by fund size.

Chart 4: Total fund assets relative to MySuper YFYS result



Source: Frontier, APRA data

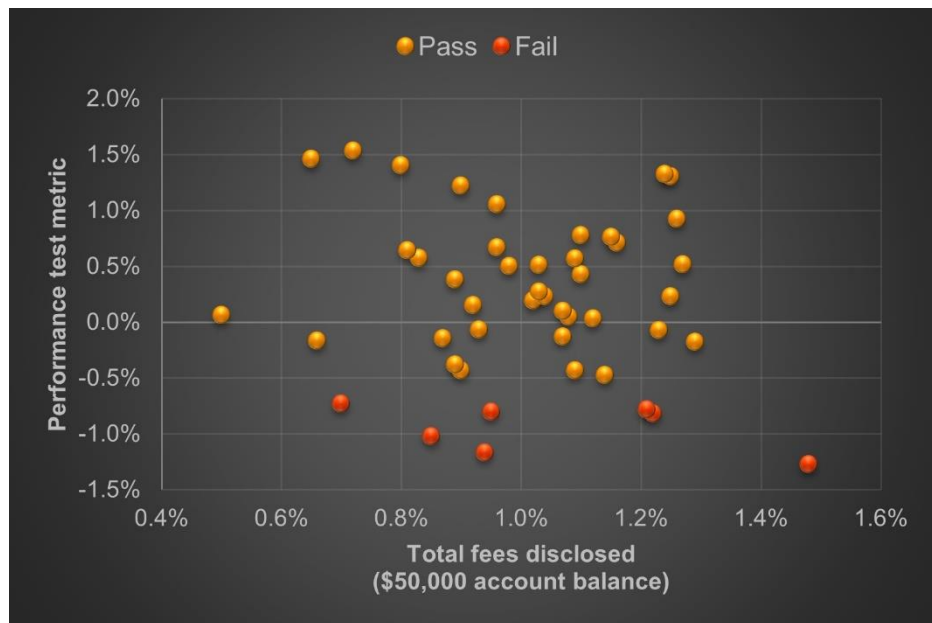
MySuper YFYS performance relative to fees

The YFYS performance test incorporates administration fees together with investment fees into the calculation. In contrast, the APRA Heatmap only considers investment fees when assessing performance. This difference can lead to the situation where a fund passes (fails) the YFYS test but fails (passes) the APRA test.

Based on the data provided by APRA, all the single strategy MySuper options which failed the YFYS performance test also failed the APRA Heatmap test. However, there was one fund which passed the YFYS performance test but failed the APRA Heatmap test. This is due to the fund's lower administration fees.

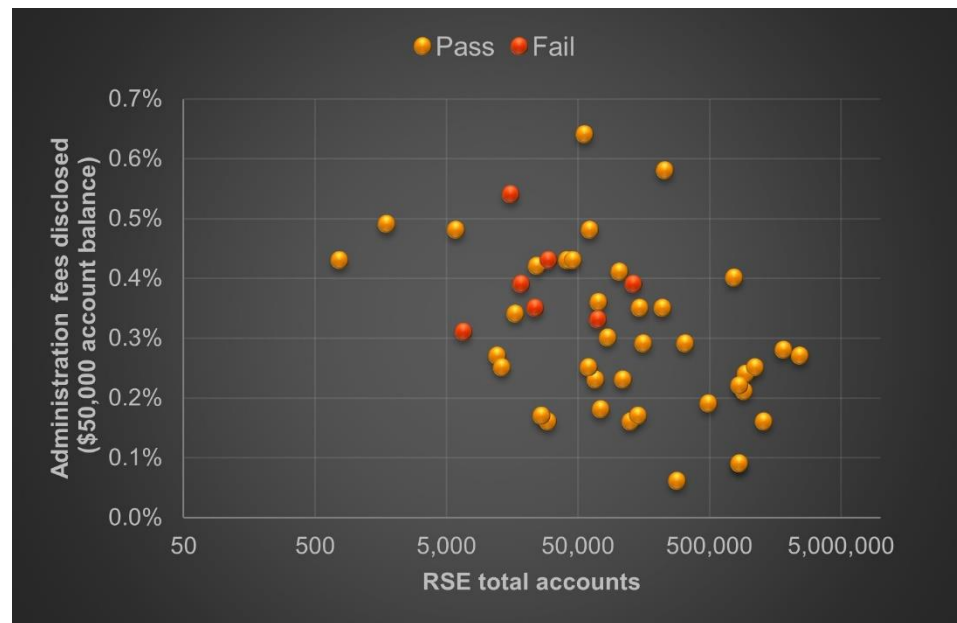
Chart 5 compares the MySuper YFYS performance relative to the total fees disclosed on a \$50,000 account balance. Overall, there is no significant relationship to suggest the total fees a member pays has a deciding impact on the final YFYS outcome. While one fund which failed had very high fees, the fees of other funds which failed are broadly similar to peers. Chart 6 compares the administration fees charged relative to the total number of member accounts. While some administration fees are observed to be lower as the total number of member accounts increases, there is no significant relationship.

Chart 5: Total fees compared to YFYS performance test result



Source: Frontier, APRA data

Chart 6: Administration fees compared to total number of RSE accounts



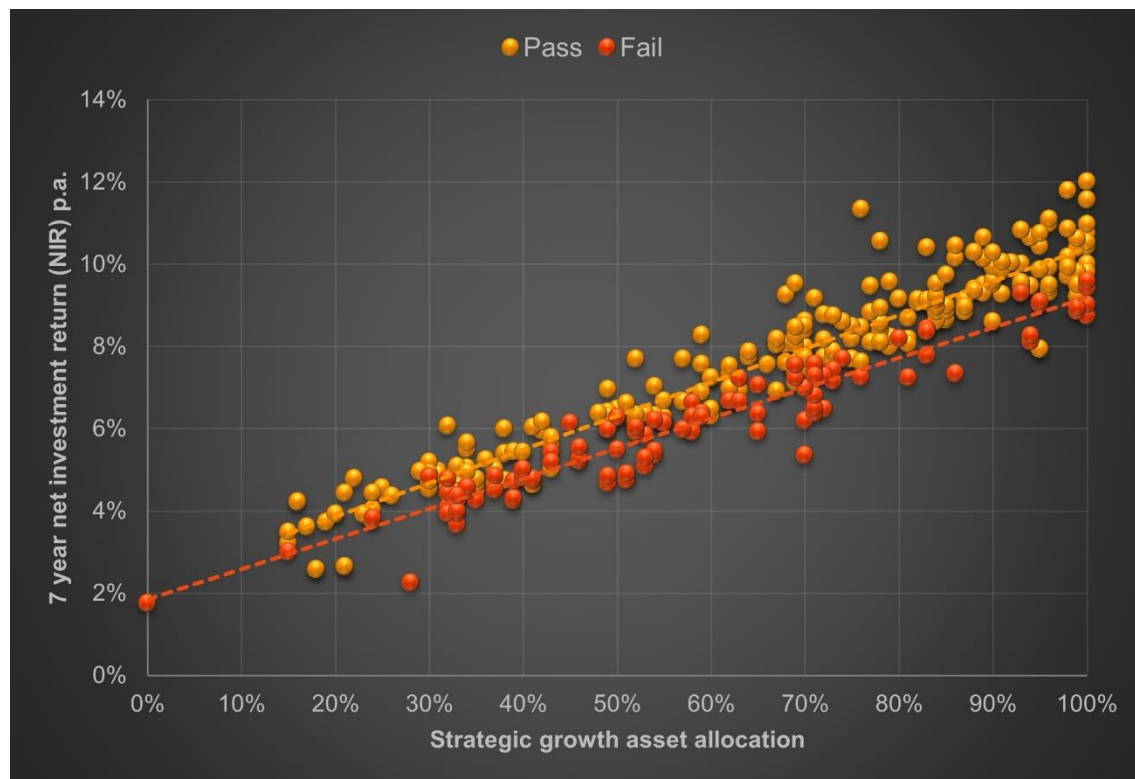
Source: Frontier, APRA data

Choice APRA Heatmap results

Chart 7 displays the Choice Heatmap results. Overall, funds which passed the Heatmap test exhibited stronger seven-year net investment return relative to funds that failed the Heatmap test, accounting for the level of growth assets as a proxy for risk. However, this isn't always the case.

Table 2 highlights 29% of Choice products (which have at least seven years' worth of returns history) failed the Heatmap test overall, with the 40-60% growth category exhibiting the highest failure rate.

Chart 7: Choice APRA Heatmap results



Source: Frontier, APRA data

Table 2: Choice APRA Heatmap results by growth ratio

Strategic growth asset allocation	Number of products ¹	failure rate ²
0 – 40%	89	34%
40 – 60%	80	50%
60 – 75%	91	27%
75 – 90%	74	11%
90 – 100%	64	19%
Total	398	29%

1. Number of products with seven years' worth of return history
2. Seven-year NIR relative to SAA benchmark portfolio below -0.5% p.a.

Choice APRA Heatmap tests

The YFYS is a 'bright-line' test, based on a single metric. In contrast, the APRA Heatmap test is calculated based on several different metrics over three, five and seven years.

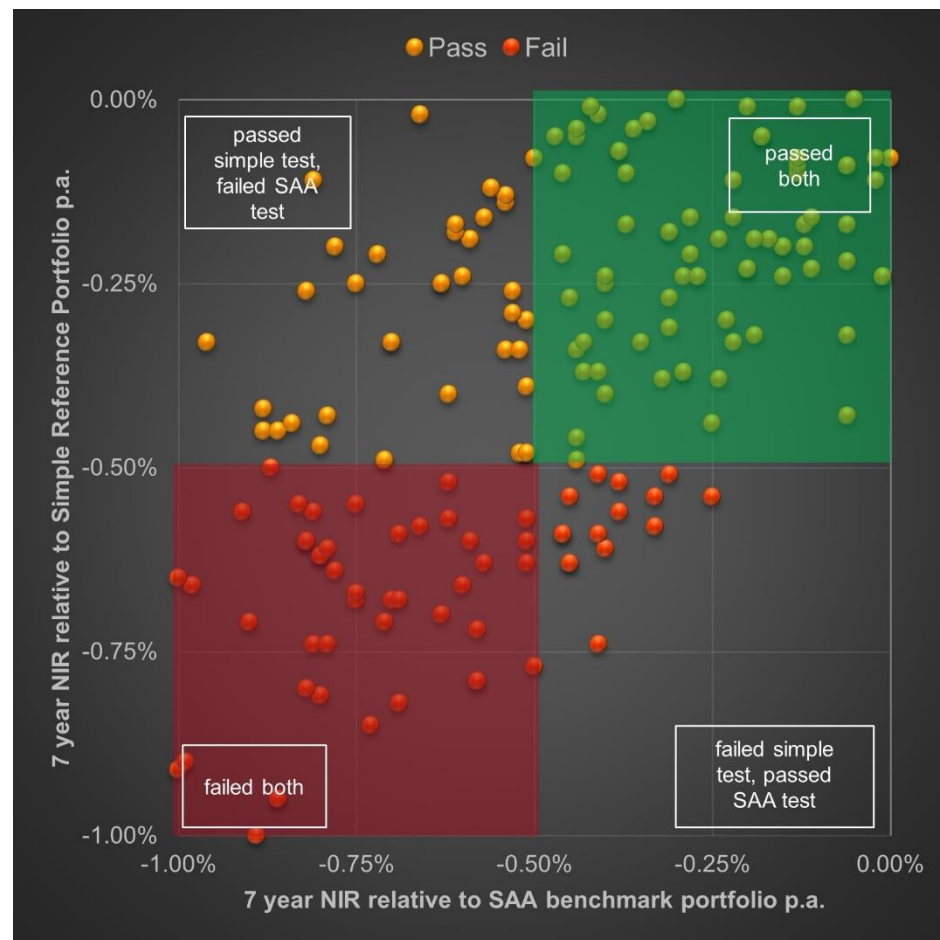
Frontier advocated for the YFYS performance test to be calculated based off a well-designed collection of multiple metrics as this is likely to be more effective and reliable than a single metric based on a narrow assessment of quality. We believe this is a better reflection of fund quality as opposed to the assessment based on past performance only.

Chart 8 plots the outcomes of Choice funds based on two APRA metrics. The Simple Reference Portfolio is deliberately 'simple' based on the growth/defensive ratio of each fund. The SAA benchmark test mirrors the YFYS calculation, without the inclusion of administration fees.

Chart 8 highlights only the funds with performance below one of the benchmarks. The key findings are summarised below:

- Most funds would have either both passed, or both failed the tests. For these funds, it wouldn't matter which test was used.
- 52 funds passed the simple test but failed the more detailed SAA test. The additional specification worked to their disadvantage.
- 15 funds failed the simple test but passed the more detailed SAA test. They benefited from greater specification of the SAA test.

Chart 8: Simple and SAA test results



Source: Frontier, APRA data

MySuper and Choice fees

APRA notes “fees and costs in Choice products are considerably higher than MySuper products, without obvious benefit in financial outcomes to members”.

There is a significant number of Choice products charging high fees – almost 25% of Choice products charge a fee greater than 1.5% for a member with a balance of \$50,000. Noting fees often decline as a percentage as the balance grows, 15% of Choice products charge more than 1.5% for a balance of \$250,000.

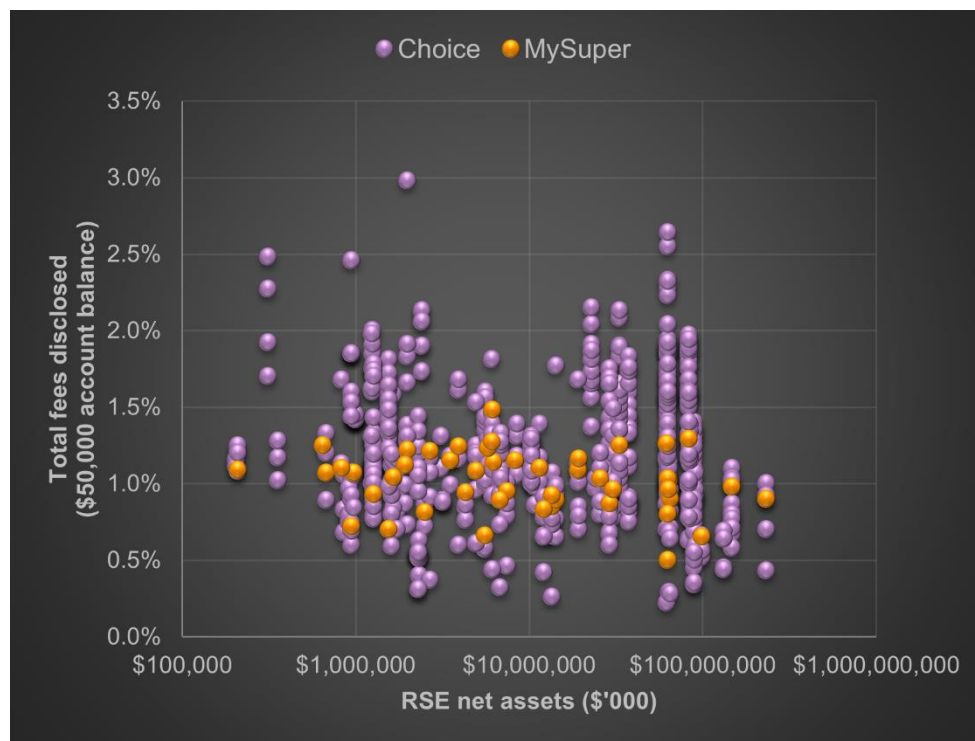
Based on Chart 9, there is no significant relationship to suggest the fees charged to members will be lower as the size of the fund increases. Larger funds may be more efficient, but this doesn’t appear to directly translate into lower fees for members.

Table 3: Distribution of total fees for \$50,000 balance

Fee	MySuper	Choice
< 0.75%	9%	12%
0.75% to 1.00%	31%	23%
1.00% to 1.25%	48%	25%
1.25% to 1.50%	12%	16%
1.50% to 1.75%	0%	13%
> 1.75%	0%	10%
Average fee	1.04%	1.19%

Source: Frontier, APRA data

Chart 9: Assets compared to fees



Source: Frontier, APRA data

Conclusion



The introduction of the YFYS performance test has already had significant impacts on the superannuation industry. Most of the funds which received a 'fail' grade are in merger talks or have already merged.

The YFYS performance test has introduced a new, short-term risk with significant consequences for funds that fail. All funds need to be factoring this into their risk framework.

Funds which received a borderline 'pass' grade will be reassessing their investment strategy with the aim of not failing the YFYS performance test at June 2022. Even those funds which have comfortably outperformed the test will be re-evaluating their exposure relative to their respective YFYS benchmarks given the test is evaluated on a rolling eight-year basis.

Improving member outcomes is a worthy aim and funds which have demonstrated persistent underperformance have no place in managing members' superannuation.

However, it is key in this assessment to identify those funds which are likely to produce poor member outcomes *in the future*. This is not an easy task.

As we've highlighted in our consultation submission, the YFYS performance test only assesses a small part of member outcomes. The test assesses how well a fund has implemented its chosen strategy, not whether it is a good strategy.

A fund with an investment strategy which will deliver poor long term member outcomes, but is well implemented, will be judged better than a fund with a good long term investment strategy but its implementation has been poor in the short term.

Ultimately, the focus should be on improved outcomes for members over the long term.



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Key features include:



Performance dashboard



APRA key metrics

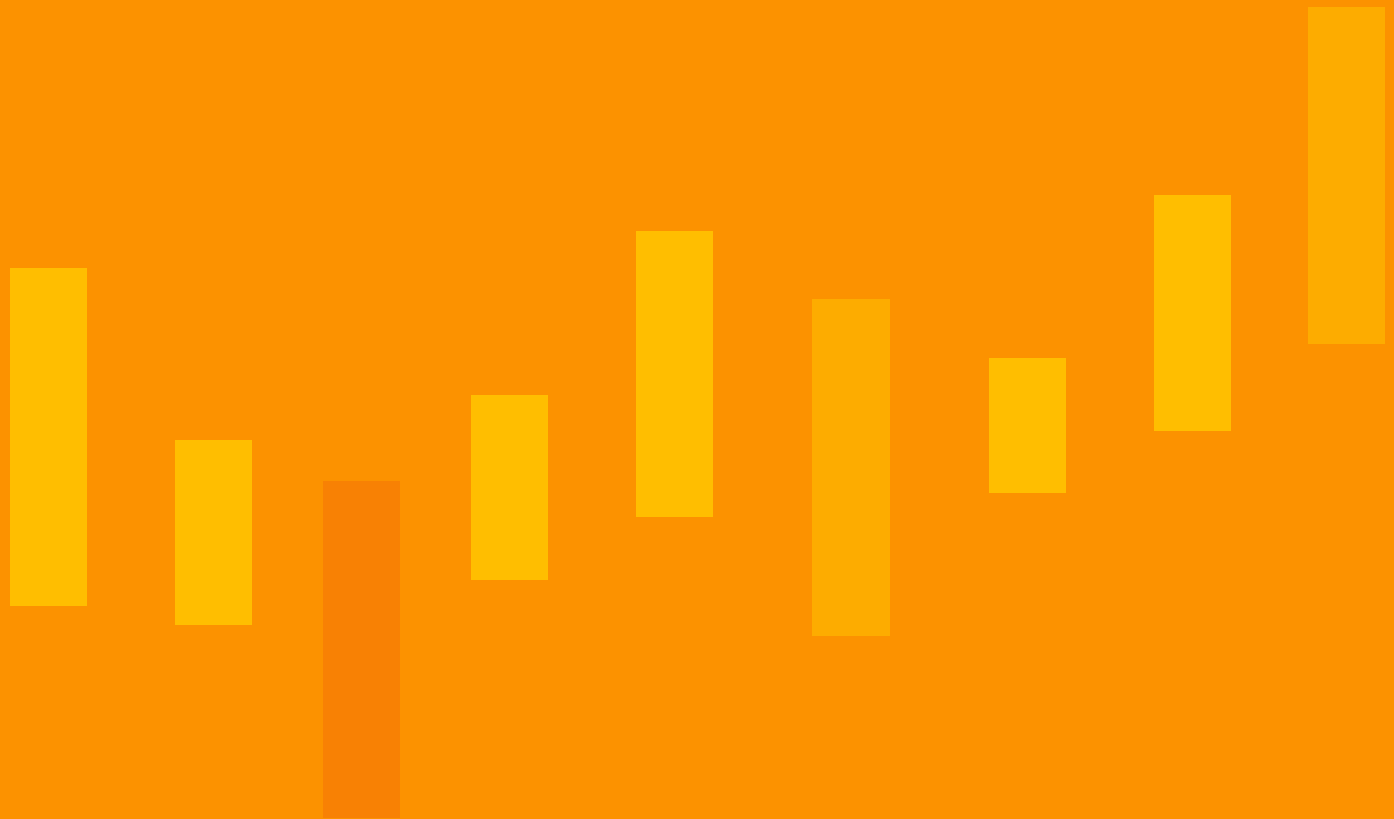


Performance attribution



Membership profile





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