19 June 2026

Ms Ruth Moore
Assistant Secretary
Member Outcomes and Governance
The Treasury
Langdon Crescent
Parkes ACT 2600

via online portal

Dear Ms Moore

RE: Treasury consultation – Strengthening the superannuation performance test

The Financial Services Council (**FSC**) welcomes the opportunity to provide a submission to the Government's consultation on *Strengthening the superannuation performance test*.

The FSC supports the objective of the performance test in protecting members from underperformance and improving confidence in the superannuation system. Since its introduction, the test has played an important role in strengthening accountability, supporting consolidation and maintaining pressure on lowering fees.

The performance test is one part of a broader consumer protection framework across superannuation. Other current reforms, including the Government's consumer protection consultation, retirement data and transparency framework, and work on customer service standards, also play an important role in improving member outcomes. This point is particularly important to consider when thinking about whether there is a compelling need to apply a blunt investment performance test, which will be complex to apply to products that are member-directed, advice-led or designed for the retirement phase, and where obligations around transparency, governance, advice and service quality are already applicable or more straightforward to apply.

About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 130 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $4 trillion on behalf of over 16.9 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pools of managed funds in the world.

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Expansion of the performance test

This consultation is an important opportunity to ensure the test remains targeted, proportionate and fit for purpose as the superannuation system evolves. The binary pass/fail framework has been effective for MySuper products, where members (often without active advice arrangements) are defaulted into a single diversified option and are generally less engaged with their superannuation. In that setting, a clear objective test with strong consequences provides an important protection against persistent underperformance. However, the same framework should not be extended further to products where members are actively engaged, often advised, and where the trustee does not control or materially influence the underlying investment strategy.

The FSC does not support extending the current test to externally directed products (**EDPs**), single-sector products or retirement products. These products are often used by engaged or advised members as part of a broader investment or retirement strategy. This includes managed fund investment options, managed accounts and model portfolio products, which are commonly used to support tailored advice, portfolio construction, tax management and member-specific investment objectives. Applying the current test to these products would risk misleading members by assessing an individual product in isolation, rather than its role within a broader portfolio or retirement strategy. It could also reduce member choice by encouraging trustees and platforms to remove products that create performance test risk, even where they remain appropriate for engaged or advised members. This would apply binary consequences in circumstances where the trustee does not control or materially influence the investment decisions driving the outcome.

This submission also identifies existing issues with the application of the test to some platform trustee-directed products (**TDPs**), particularly where the connected entity provisions capture products despite the trustee not controlling or materially influencing the underlying investment strategy or directing members' investment decisions. The FSC recommends Treasury review these settings as part of any reform package.

Targeted and proportionate changes

The FSC supports targeted improvements to the existing benchmark framework. This includes introducing a CPI+X pathway for emerging and alternative asset classes that are not appropriately captured by existing prescribed benchmarks, subject to clear eligibility criteria, prospective application, appropriate safeguards and separate settings for growth and defensive assets.

These reforms would help ensure the test does not unnecessarily discourage trustees from investing in assets that are in members' best financial interests, including long-term investments that may support broader national priorities. This is particularly relevant for assets where long-term institutional capital can play an important role, such as social and affordable housing, infrastructure, energy transition, farmland, timberland and other natural capital assets which are inherently linked to long-term sustainability themes and are commonly implemented in responsible investment approaches. Without appropriate design, the test risks creating structural barriers to these approaches, despite their focus on financially material, forward-looking risks and opportunities and their relevance to long-term member outcomes, provided the investment is consistent with trustees' obligations to members.

By contrast, replacing the current framework with a simple reference portfolio would not be a proportionate response. It would represent a significant redesign of the test, create new investment incentives and impose transition and implementation costs on members.

The FSC also supports a regular benchmark review process to ensure the framework remains fit for purpose as markets evolve and better data, including responsible investment indicators, becomes available. This should include consideration of the cost and accessibility of prescribed benchmark indices.

The FSC welcomes the opportunity to further discuss the matters outlined in this submission. The FSC is also undertaking further research on the potential impacts of the reform options. We would be pleased to provide Treasury with additional information as this work becomes available and look forward to discussing these issues with you and your team as you work through them.

In the meantime, if you have any questions relating to our submission, please do not hesitate to reach out to me on 0421 944 648 or by email (ajohnson@fsc.org.au).

Yours sincerely

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Test externally directed accumulation products (Option 4)

1.1 Do not extend the current pass/fail performance test to externally directed products;

1.2 Do not include SMAs, MDAs, model portfolio products or customised managed account portfolios in the performance test;

1.3 Any reporting requirements for SMAs, MDAs, model portfolio products or customised managed account portfolios, including SAA reporting, should be developed prospectively and recognise the difference between model, shadow and actual member performance;

1.4 Consider a separate transparency mechanism for EDPs to support comparability of performance and fees without imposing pass/fail consequences, red/amber-style ratings, failure labels, member notifications or product closure consequences;

1.5 Any EDP transparency framework should be developed through detailed consultation and reflect the role of EDPs in member-directed and advice-led portfolios;

1.6 Do not extend the current binary performance test to single-sector products. Any future reform should focus on transparency and comparability;

1.7 Do not extend the current performance test to retirement products; and

1.8 Use the Government's retirement transparency framework to improve comparability before considering any tailored retirement product assessment.

The current test produces misleading outcomes for platform TDPs

2.1 Calculate benchmark RAFE for platform TDPs using currently available fee data from a broader platform cohort, rather than only the small number of platform products currently captured by the test;

2.2 Set the representative member balance for platform TDPs by reference to the median balance of the platform cohort, rather than the current $50,000 balance;

2.3 A proportion of the total dollar-based administration fee, representative of the average or median number of investment options held in a platform or non-platform TDP, should be assessed in the performance test for TDPs;

2.4 Treasury and APRA should assess whether the tax treatment of platform TDPs creates distortions in performance test outcomes and consider a targeted adjustment, including to the failure threshold, where needed to reflect individualised member tax outcomes; and

2.5 Remove failure notification requirements for platform TDPs. If notification requirements are retained, amend the notices so they explain the option-level nature of the test, provide appropriate portfolio context, and not direct members to the YourSuper comparison tool.

Adjust for emerging and alternative asset classes (Option 1)

3.1 Introduce a targeted CPI+X benchmark for emerging and alternative asset classes that are not appropriately captured by existing prescribed benchmarks, with eligibility determined prospectively and supported by clear safeguards to preserve the integrity of the performance test;

3.2 Eligibility for the CPI+X covered asset class should be principles-based, prospective and limited to assets that are not appropriately captured by existing benchmarks, with safeguards delivered through guidance, trustee documentation and ongoing monitoring;

3.3 APRA should set separate CPI+X targets for growth and defensive assets, calibrated on a long-term basis using a real cash rate assumption and appropriate risk premia. As a starting point, APRA could consider CPI+3 per cent for growth assets and CPI+1 per cent for defensive assets;

3.4 APRA should provide principles-based guidance on the classification of growth and defensive assets, recognising the asset's source of return, market risk, development risk, cashflow profile, portfolio role and lifecycle stage. The X component should be reviewed every 10 years, or earlier only where clearly warranted;

3.5 The treatment of assets with a development or J-curve return profile should be tailored, including allowing these assets to be reported against the relevant CPI+X benchmark but excluded from the overall pass/fail performance assessment for a time-limited development period, such as three years, where appropriately justified by the trustee;

3.6 The CPI+X covered asset class should be subject to a 10 per cent allocation cap for performance test purposes, operating as a backstop safeguard that limits excessive use of the category without unnecessarily restricting trustee investment decisions;

3.7 Apply the CPI+X covered asset class prospectively, with APRA guidance and at least 12 months' transition before commencement; and

3.8 Introduce a targeted CPI+X pathway for alternative assets that are not appropriately captured by the current Alternatives benchmarks, with separate growth and defensive hurdles, while retaining the existing Alternatives treatment where it remains suitable.

Introduce an assessment of risk-adjusted returns (Option 2)

4.1 The current strategic asset allocation benchmark framework should not be replaced with a simple reference portfolio test, given the significant design, transition and implementation risks. Targeted benchmark improvements are a more proportionate way to address investment constraints while preserving the integrity of the performance test.

Introduce a routine review of the benchmarks (Option 3)

5.1 Introduce a formal three-yearly review of the performance test benchmarks to ensure they remain fit for purpose and can be updated prospectively as markets evolve and suitable new benchmarks become available;

5.2 Amend the performance test framework to enable APRA to specify the prescribed benchmarks through an APRA-administered legislative instrument, with APRA responsible for undertaking a three-yearly benchmark review and consulting on any prospective benchmark updates;

5.3 Allow products with clearly disclosed sustainability, values-based or climate-transition objectives to use a customised benchmark where the standard benchmark does not reflect the product's stated investable universe, subject to prospective application, independent verification and APRA oversight; and

5.4 Assess options to address the cost and accessibility issues created by prescribed benchmark indices, including publication requirements, reasonable pricing arrangements, alternative approved benchmarks and potential ACCC advice.

1. Test externally directed accumulation products (Option 4)

16. Are there specific products for which performance testing would be unsuitable? If so, why? Provide evidence or examples to support your views.

17. How could the test be extended to externally directed products? What design elements need to be considered?

18. What are the key implementation and transition considerations in extending the test to externally directed products?

The FSC does not support extending the current binary pass/fail performance test to EDPs.

The performance test should only apply where a trustee controls, or materially influences, the design and implementation of the investment strategy being tested. This is the basis on which the test can fairly hold trustees accountable for investment performance and fees. It was also the policy principle intended to underpin the extension of the test beyond MySuper to TDPs.

The current TDP framework has not always achieved that policy intent. The connected entity provisions can capture platform TDPs where the trustee does not control or materially influence the underlying investment strategy, and where the trustee's practical role is limited to menu selection, due diligence and ongoing monitoring. This is a design flaw in the current framework because corporate connection should not determine whether a product is subject to binary performance test consequences where trustee control is absent.

EDPs raise the same core issue. For EDPs, the trustee's role is generally focused on due diligence, menu selection, setting any relevant holding limits, ongoing monitoring and determining whether the product should continue to be made available to members in accordance with their investment governance obligations. The trustee does not control the underlying investment decisions, portfolio construction or asset allocation that ultimately drive performance outcomes. Extending a pass/fail consequence regime to EDPs would therefore further entrench a misalignment between regulatory accountability and trustee control.

EDPs are also not a homogeneous product category. They can include single-manager funds, multi-manager products, model portfolios, managed accounts and other externally managed strategies with different investment objectives, mandates, asset classes, risk profiles, fee structures and portfolio roles. This is particularly important for managed accounts, where members and advisers may value transparency, asset portability and efficient access to capital markets, rather than assessing the product only by standalone performance against a generic benchmark.

The fact that trustees control menu selection does not mean the performance test is the right tool for assessing EDP outcomes. Menu selection, due diligence, holding limits and ongoing monitoring are investment governance matters. Where there are concerns about poor investment governance or product selection, these should be addressed through trustees' existing governance obligations, member outcomes assessments and APRA supervision. Performance testing the underlying investment option would not directly address whether the trustee's menu selection and monitoring processes were appropriate, and could instead produce misleading outcomes for members.

Treasury should therefore avoid expanding the test in a way that replicates or exacerbates the existing issues with platform TDPs. It should also review the connected entity treatment for platform TDPs to ensure products are not subject to binary pass/fail consequences solely because of corporate connection where the trustee does not control the investment strategy and where there are arguably legitimate reasons in the best financial interest of the member to include that particular platform TDP option in the context of a diversified portfolio.

Treasury's consultation paper acknowledges the scale and complexity of extending the test to EDPs, noting that up to 7,500 additional products across 37 superannuation entities could be brought into scope, including around 3,500 single or multi-manager products and approximately 2,700 model portfolio products. This would materially exacerbate the issues already evident in the current testing of platform TDPs by extending a binary assessment framework into a broader and more diverse part of the market that is not suited to a single pass/fail test.

This expansion would disproportionately affect platform-based superannuation products, which are designed to provide broad investment menus across numerous underlying managers and strategies. Unlike MySuper products, platform products are typically used by engaged members, often with advice, to construct diversified portfolios. Applying a binary test to each underlying product in isolation would not reflect how these products are selected, monitored or used by members.

RECOMMENDATION 1.1

Do not extend the current pass/fail performance test to externally directed products.

EDPs are member-directed and often advice-led

EDPs operate differently to MySuper products and trustee-designed diversified options. These products are typically selected by engaged members, often with the assistance of a financial adviser, for the role they play within a diversified portfolio rather than their standalone performance relative to a single benchmark.

This same practical issue can arise for platform TDPs where the trustee does not control or materially influence the underlying investment strategy. In both cases, a binary test risks assessing one component of a member's portfolio in isolation, rather than considering the role it plays in the member's broader investment strategy.

A failure notice could therefore be misleading where the product remains appropriate as part of a diversified or advice-led portfolio. It could also cut across the role of financial advice, where the adviser is responsible for considering the member's personal circumstances, objectives, risk profile and overall portfolio construction.

Where there are concerns about poor menu selection or investment governance, these should be addressed through existing trustee obligations, including due diligence, ongoing monitoring, member outcomes assessments and removing products from menus where warranted. These obligations are addressed through APRA's *Superannuation Prudential Standard SPS 530 Investment Governance* and the FSC's recently made *Standard 31 Wrap Superannuation Platform Trustee Investment and Adviser Governance Principles: Standard and Better Practice Guidance*.

Managed accounts require separate consideration

Separately managed accounts (**SMAs**) and model portfolio products should not be subject to the performance test.

Unlike trustee-directed diversified products, SMAs are generally selected by engaged members and their advisers as part of a broader investment strategy. They may be used alongside other assets, customised through substitutions or exclusions, and managed with regard to tax, cashflow and client-specific objectives. A static test applied to a representative model portfolio would not reflect how members actually experience these products.

Applying a binary test to these products could undermine tailored adviser recommendations and create confusion for advised clients, particularly where the managed account remains appropriate having regard to the member's objectives, risk profile, tax position and broader portfolio. Adding further complexity, SMAs may also include EDPs within their model portfolio, raising similar trustee control issues with respect to the test as raised in the section above.

This may also create tension with the personal advice provided to the member, including where switching could trigger tax consequences or require further adviser review. As discussed in the section on platform TDP failure notices, this could increase advice costs, without a clear link to improving member outcomes.

Customised managed account portfolios are particularly unsuitable for the performance test. These portfolios may be developed with an advice group to reflect its investment philosophy, client base, target market determination, existing client holdings, embedded tax positions and risk appetite. Members access these portfolios through an advice relationship, with active advice intermediation.

In practice, managed accounts and model portfolios may involve a degree of customisation at the individual member level. This may include asset substitutions, security exclusions due to members' personal or religious preferences, and variations due to trade minimisation and tax outcomes.

A standardised performance assessment applied to a representative model portfolio would not adequately capture these variations, increasing the risk that test outcomes do not reflect the experience of members. Reported performance may also be based on a model or shadow portfolio, rather than the actual performance experienced by individual members, which can differ due to cashflows, settlement timing, rebalancing timing, partial implementation and account-level customisation.

Extending the test to SMAs would also create significant comparability issues. SMA models can include direct equities, income strategies, multi-manager portfolios, tax-aware strategies and bespoke asset class exposures. Consistent SAA reporting has also not historically been mandated across platforms. If SAA reporting were to be a requirement, it should apply prospectively and only from the point at which consistent reporting standards took effect.

The FSC is concerned about the risk that a standardised benchmark framework favours low-cost, benchmark-like models and discourages active, specialist or higher-conviction strategies, even where those strategies are appropriate for advised members.

This could have material consequences for the managed accounts market. Investment managers, including boutique and specialist managers, may withdraw from superannuation platforms rather than accept performance test failure risk caused by inconsistently and inappropriately applied platform fees, inappropriate benchmarks or factors outside their control. This would reduce member choice, increase concentration among a smaller number of managers and distort competition between SMAs and equivalent investment strategies offered outside the test.

There is also a risk that members and advisers move away from SMAs towards less transparent structures, such as model portfolios implemented outside trustee oversight. This would be a poor policy outcome, as it could reduce trustee visibility, increase compliance and monitoring costs, reduce efficiency across the advice market, increase the cost of advice and reduce accessibility.

RECOMMENDATION 1.2

Do not include SMAs, MDAs, model portfolio products or customised managed account portfolios in the performance test.

RECOMMENDATION 1.3

Any reporting requirements for SMAs, MDAs, model portfolio products or customised managed account portfolios, including SAA reporting, should be developed prospectively and recognise the difference between model, shadow and actual member performance.

A binary test would reduce investment diversity

The current application of the binary performance test to platform TDPs where the trustee does not control or materially influence the underlying investment strategy is already affecting product availability and investment menu design. FSC members have indicated that the test has contributed to pressure to rationalise or avoid certain differentiated investment options, particularly where outcomes may be affected by benchmarks, fees or factors outside the investment manager's control.

Extending the test to EDPs would materially exacerbate this issue. External investment managers, particularly those offering specialist, higher-conviction or alternative strategies, may reconsider participation in superannuation platforms if they face public failure risk due to the inappropriate application of the test to factors outside their control.

Many EDPs are designed to operate as one component of a diversified portfolio, not as a standalone whole-of-portfolio solution. They may be selected to provide exposure to a particular asset class, investment style, manager capability or market segment that complements the member's broader asset allocation. Testing these products individually would not reflect the way diversification works in practice. Large diversified MySuper products also combine different managers, styles and convictions to diversify risk and smooth performance over time. Applying a binary test to each component in isolation would therefore be inconsistent with the way well-diversified portfolios are constructed and managed.

A binary test would therefore create incentives for trustees, platforms and external managers to avoid products that are more likely to create tracking error against prescribed benchmarks, even where those products play an appropriate role within a diversified portfolio for engaged or advised members. Over time, this could push investment menus towards benchmark-like products and away from active, specialist, alternatives, private market and single-sector strategies that may lead to better outcomes for members in the long-run.

This could also reduce access to capital for asset classes and sectors that rely on long-term institutional investment, including infrastructure, housing, energy transition assets, venture capital and other areas reliant on deep capital markets which are important for productivity growth. This would be a poor outcome in an environment where Australia needs to support productive investment.

It could also create incentives for advisers to move away from multi-asset products or managed portfolio solutions and instead construct portfolios using individual investment options. This would reduce scale and efficiency, make portfolio-level outcomes harder to benchmark, and could increase the cost of advice for members.

These outcomes would cause member harm by narrowing investment choice, undermining considered financial advice, increasing costs, and reducing access to diversified or specialist strategies that may be appropriate within a member's broader portfolio.

Benchmarking and fee issues would produce unreliable outcomes

The current performance test framework is not well suited to the diversity of EDPs, or to platform TDPs where the trustee does not control or materially influence the underlying investment strategy. These products can vary significantly by investment objective, mandate, asset class, risk profile, fee structure and portfolio role. A standardised benchmark framework will struggle to compare these products fairly, particularly where the product is selected as one component of a broader member portfolio rather than as a standalone diversified option.

The consultation paper also recognises that the same EDP could have different administration fees depending on the platform through which it is offered, meaning an identical product could pass in one fund but fail in another largely because of administration fees rather than investment performance. This disparity is already evident in APRA's annual performance reporting, where the same underlying fund exposure can receive different outcomes depending on the registered superannuation entity issuer of the option.

This reflects more than a comparability challenge. Differences in administration fee structures across platforms introduce a source of systematic bias into the test framework, meaning identical investment products may deliver different performance test outcomes depending solely on the platform through which they are accessed. These outcomes do not reflect differences in investment merit, but rather structural features of the test design, which undermines its reliability as a measure of member outcomes.

Administration fees charged on a platform are for the costs of accessing a comprehensive digital product and service experience, not just access to an investment option. Examples of services provided include detailed and consolidated portfolio reporting that can be personalised to the member enabling a whole of wealth and goals-based view, detailed investment research tools, tax reporting, consolidation and administration, cash flow visibility and allocation, and access to a range of insurance products. These services are offered irrespective of the EDP (or number of EDPs) selected.

This would undermine the credibility of the test and could create unfair reputational consequences for external managers.

The $50,000 representative member balance will not accurately reflect many EDP investors, particularly in platform and managed portfolio contexts. This issue arises because the use of a single representative balance does not reflect the characteristics of all product types. Platform-based products are typically used by members with higher balances than those assumed in the test. Applying a uniform balance assumption can therefore overstate the impact of certain fee structures, particularly where flat or tiered fees apply, and lead to distorted comparisons between product types.

Static representative portfolios may also fail to capture cashflows, sequencing, substitutions, exclusions, rebates, customisation and the way the EDP is used within a broader advised strategy.

A transparency mechanism is more appropriate

If the Government is concerned about visibility of EDP performance, the FSC would support consideration of a transparency mechanism rather than a binary performance test.

A disclosure-style framework could provide comparable information on investment performance, fees and relevant product characteristics without imposing pass/fail consequences. For the avoidance of doubt, the FSC does not support red/amber-style ratings, failure labels, product closure consequences or member notifications that replicate the effects of the current performance test. Any transparency mechanism could build on APRA's Superannuation Data Transformation project, which has progressively increased the quality, breadth and depth of data collected from issuers of EDPs.

A transparency framework would better suit the higher engagement and advice-supported nature of EDP investors. It would provide useful information to members, advisers and trustees without creating misleading failure notices or unnecessary product closure consequences.

This approach would also align more closely with the trustee's actual role in relation to EDPs, which is to undertake due diligence, monitor the menu and take appropriate action where an option is not delivering appropriate outcomes. The FSC has previously submitted that the focus for EDPs should be on the trustee's monitoring and response processes, including how underperforming options are reviewed, communicated to advisers and members, and closed where appropriate.

RECOMMENDATION 1.4

Consider a separate transparency mechanism for EDPs to support comparability of performance and fees without imposing pass/fail consequences, red/amber-style ratings, failure labels, member notifications or product closure consequences.

Implementation considerations

Extending the performance test to EDPs would represent a significant increase in operational complexity. Trustees would be required to apply consistent approaches to benchmark selection, fee measurement and performance calculation across a large and highly heterogeneous set of products.

These requirements would overlap with existing investment governance and member outcomes obligations, increasing regulatory burden and compliance costs without a clear corresponding benefit to member outcomes.

Any EDP transparency framework should be developed separately from the existing performance test and subject to detailed consultation. Key design issues would include product scope, comparability groups, fee assumptions, treatment of rebates and platform fees, data availability, reporting standards and how information is presented to avoid implying that a product is unsuitable where it remains appropriate within a broader portfolio.

This reflects the fundamental distinction between default products, where the provider determines the investment strategy, and member-directed or advice-led products, where investment outcomes depend on portfolio construction rather than the performance of individual components in isolation.

Australia's performance test is internationally distinctive in applying prescriptive, binary outcomes to product performance. Comparable regimes in other jurisdictions focus on transparency, trustee accountability and supervisory oversight, and do not extend such consequences to individual investment options within member-directed or advice-led product structures.

RECOMMENDATION 1.5

Any EDP transparency framework should be developed through detailed consultation and reflect the role of EDPs in member-directed and advice-led portfolios.

Single-sector products are portfolio building blocks

19. What are the key considerations in extending the test to single-sector products?

The FSC does not support extending the current binary performance test to single-sector products.

Single-sector products are generally used as one component of a broader member portfolio. They are selected by engaged members, often with advice, to provide exposure to a particular asset class, market segment or investment style. Testing these products in isolation would not reflect how they are used by members and a ‘fail’ result risks being misleading.

A binary test would also significantly limit product diversity. Unlike diversified multi-asset products, single-sector products have limited ability to manage performance test risk through asset class diversification. To reduce the risk of failure, these products would need to track prescribed benchmarks closely, which would discourage active management, specialist strategies, values-based approaches and differentiated investment styles.

A fair test for single-sector products would require a much broader and more granular benchmark framework than currently exists. For example, fixed income strategies may require different treatment for fixed-rate and floating-rate investment grade issuance, high yield credit, emerging market debt, duration exposures and other specialist strategies. Investment managers use a broad range of benchmarks to reflect the objectives and risk profile of different strategies. Unless the test is supported by a broad menu of precise benchmarks, it would be too blunt to assess single-sector products effectively.

This would narrow the range of investment options available to members and could reduce access to products that play a legitimate role in portfolio construction. Any further consideration of single-sector products should focus on transparency and comparability.

RECOMMENDATION 1.6

Do not extend the current binary performance test to single-sector products. Any future reform should focus on transparency and comparability.

Transparency should come before testing retirement products

20. What are the key considerations in extending the test to retirement products?

21. Could performance testing retirement products create risks to broader retirement income objectives? If so, what are these risks and how could they be mitigated?

The FSC does not support extending the current binary performance test to retirement products.

Retirement products are designed to achieve different objectives to accumulation products. They must balance investment performance with income generation, longevity risk management, inflation risk, sequencing risk and flexible access to capital. A test focused primarily on investment performance and fees would not adequately capture these broader objectives and would likely lead to poor member outcomes as the purpose of the retirement product would be overshadowed by an arbitrary performance metric.

Applying the current test could also create risks to the Government’s retirement income policy objectives. It may encourage trustees to design simpler, benchmark-tracking products that are easier to test, rather than developing innovative income solutions that better manage longevity, income stability and member flexibility. This could stifle innovation at a time when the retirement phase market is still developing.

Members approaching or entering retirement are also more likely to be engaged, seeking guidance or receiving financial advice. A binary fail outcome could prompt members to switch out of a product that remains appropriate for their personal retirement needs, particularly where the product forms part of a broader retirement income strategy.

This risk is more acute for retirement products because some product features and benefits may not be recoverable once a member exits. For example, if a member leaves an innovative retirement income stream product, they may lose access to benefits or features that cannot be reinstated if they later seek to re-enter. A failure notice could therefore create irreversible member detriment where it prompts switching that is not aligned with the member's retirement income needs.

The Government should first focus on the retirement transparency framework it is already developing, expecting to begin from 2028. This should be used to improve comparability and help members approaching retirement assess income, risk management, flexibility, fees and performance. Any further consideration of a retirement product assessment should be developed separately from the accumulation performance test and aligned with the objectives of the Retirement Income Covenant.

RECOMMENDATION 1.7

Do not extend the current performance test to retirement products.

RECOMMENDATION 1.8

Use the Government's retirement transparency framework to improve comparability before considering any tailored retirement product assessment.

2. The current test produces misleading outcomes for platform TDPs

The FSC also recommends Treasury review the current application of the performance test to platform TDPs. The key issue should be whether the trustee controls, or materially influences, the design and implementation of the investment strategy, not whether the investment manager or responsible entity is part of the same corporate group. Where the trustee's role is limited to menu selection, due diligence and ongoing monitoring, platform TDPs raise the same accountability and control issues as EDPs and should not be subject to binary pass/fail consequences.

Benchmark RAFE calculation for platform TDPs

A key issue with the current testing of platform TDPs is that the benchmark representative administration fees and expenses (**RAFE**) is calculated from a very small cohort of captured platform products.

This means the benchmark can be materially affected by the pricing decisions of one captured trustee, rather than reflecting fees across the broader platform market. Where one provider materially reduces fees, the benchmark can shift significantly, causing another platform TDP to fail even though its fees may not be out of step with the broader market and the trustee has no control over the pricing decisions of other providers.

This creates an unstable and unrepresentative benchmark for platform products. The benchmark RAFE should instead be calculated using fee data from a broader platform cohort that APRA already collects, including relevant platform products that are not currently captured by the test. This would provide a more reliable benchmark and better reflect the fees members pay across comparable platform products.

RECOMMENDATION 2.1

Calculate benchmark RAFE for platform TDPs using currently available fee data from a broader platform cohort, rather than only the small number of platform products currently captured by the test.

Representative balances should reflect platform cohorts

The current $50,000 representative member balance is not appropriate for platform TDPs.

Platform products are generally used by members with higher balances than the representative balance used in the test. For example, a $250,000 balance may be more reflective of the platform cohort than a $50,000 balance. Applying the same representative balance used for MySuper products can materially overstate the fee impact for platform members and produce distorted results.

This is particularly relevant where platforms charge flat dollar administration fees or tiered fees. A flat annual fee has a much larger percentage impact at $50,000 than it does at higher balances. As a result, the test can make platform products appear less competitive than they are for the members who actually use them.

The representative balance for platform TDPs should be based on the median balance of members in the platform cohort, rather than applying a single $50,000 balance across the market. This would better reflect actual member experience and improve the reliability of fee comparisons.

Further to this, dollar-based administration fees for choice products, including TDPs, apply at the account level rather than at the investment option level. Assessing the full value of the dollar-based administration fee for each investment option tested does not reflect actual member outcomes and can materially overstate the fee impact and produce distorted results for members.

The proportion of the dollar-based administration fee assessed in the test should be based on the average number of investment options held for a platform TDP or non-platform TDP member. This can be determined using APRA data on the number of members by investment pathway.

RECOMMENDATION 2.2

Set the representative member balance for platform TDPs by reference to the median balance of the platform cohort, rather than the current $50,000 balance.

RECOMMENDATION 2.3

A proportion of the total dollar-based administration fee, representative of the average or median number of investment options held in a platform or non-platform TDP, should be assessed in the performance test for TDPs.

Tax treatment should reflect individual member outcomes

The current test should better recognise the different way tax is applied in platform TDPs compared with pooled master trust products.

In pooled products, tax outcomes are generally reflected through the unit price or crediting rate of the investment option. In platform products, tax impacts and benefits can be allocated more directly to individual member accounts, including through the attribution of realised capital gains, realised losses, franking credits and other tax adjustments. This means the tax outcome experienced by members can vary depending on their individual holdings, transactions and timing.

This can create distortions when platform TDPs are assessed against a benchmark return that applies standardised tax assumptions. The test may not fully recognise the tax benefits or detriments experienced by individual members, particularly where tax outcomes are not pooled in the same way as a master trust product. As a result, the performance test outcome for a platform TDP may not accurately reflect the after-tax outcome experienced by members.

The Government should work with APRA and industry to assess whether the current tax assumptions create a systematic disadvantage for platform TDPs. If this cannot be resolved directly through the calculation methodology, the Government should consider a targeted adjustment to the failure threshold for platform TDPs to account for tax treatment differences. This could involve a modest expansion of the current 50 basis point buffer where there is evidence that the difference is driven by the structure of tax attribution rather than genuine underperformance.

Any adjustment should be carefully calibrated and limited to addressing tax treatment differences, so that the integrity of the test is maintained.

RECOMMENDATION 2.4

Treasury and APRA should assess whether the tax treatment of platform TDPs creates distortions in performance test outcomes and consider a targeted adjustment, including to the failure threshold, where needed to reflect individualised member tax outcomes.

Platform TDP failure notices

The FSC considers that failure notification requirements should be removed for platform TDPs where the trustee does not control or materially influence the underlying investment strategy. These notices can be misleading because they relate to a specific investment option only and may not reflect the member's overall portfolio, personal circumstances, tax position, investment objectives or the role the option plays in an advised strategy.

If notification requirements are retained, they should be materially amended. Notices should clearly explain the option-level nature of the test, provide appropriate portfolio context, and avoid implying that the member should switch out of the option without considering their broader circumstances.

The notices should also remove references to the YourSuper comparison tool. MySuper products are unlikely to be suitable substitutes for many platform TDPs, particularly where the member is using a platform to access a tailored portfolio, specialist strategy, managed account or advice-supported arrangement.

RECOMMENDATION 2.5

Remove failure notification requirements for platform TDPs. If notification requirements are retained, amend the notices so they explain the option-level nature of the test, provide appropriate portfolio context, and not direct members to the YourSuper comparison tool.

3. Adjust for emerging and alternative asset classes (Option 1)

Introduce a new emerging covered asset class (Option 1.1)

1. To what extent does the test constrain decisions to invest in certain asset types? Which asset types are most affected, and why? Provide evidence or examples to support your views.

2. To what extent would a new covered asset class with a CPI + X benchmark address investment constraints the test may impose? Provide evidence or examples to support your views.

The current performance test can constrain investment in asset classes that are not well represented by the prescribed benchmarks. This is not because the assets are inherently inappropriate for superannuation investment, but because the current benchmark framework can create artificial tracking error where an asset's risk and return profile does not align with the benchmark it is tested against. This effect may be reinforced by the backward-looking nature of the performance test, which relies on historical returns and may not adequately capture expected long-term return profiles or forward-looking risks, including transition-related risks such as asset repricing or stranding.

This can discourage trustees from allocating to assets that may support diversification, inflation protection, downside resilience or long-term member outcomes. Examples include alternative fixed income, hedge funds and liquid alternatives, some private credit strategies, infrastructure, social and affordable housing, venture capital, timberland, farmland and other natural capital assets. Many of these assets are typically accessed through responsible investment approaches and are central to long-term structural themes such as the energy transition and nature-positive investment, both of which are integral to the orderly transition to a net zero economy and require sustained long-term institutional capital. Some of these assets may be particularly valuable in periods where equity and bond correlations increase, but can be difficult to allocate to under the current benchmark settings.

A CPI+X benchmark could help address these constraints for assets where no suitable market index exists or where available indices are not representative, transparent or sufficiently mature. It would provide a more stable and objective benchmark for assets whose return drivers are not closely linked to listed equity or fixed income markets.

CPI+X should therefore be used as a targeted solution, not as a broad replacement for the existing benchmark framework. It would be most appropriate for emerging or alternative asset classes where the trustee can demonstrate that the asset is not appropriately captured by an existing prescribed benchmark. It should also operate prospectively to avoid retrospectively changing the basis on which past investment decisions were made.

The FSC supports further consideration of a CPI+X benchmark as part of a targeted reform package, alongside improvements to existing benchmarks and a routine benchmark review process. This would provide trustees with greater flexibility to invest in assets that are in members' best financial interests, while preserving the objectivity and integrity of the performance test.

RECOMMENDATION 3.1

Introduce a targeted CPI+X benchmark for emerging and alternative asset classes that are not appropriately captured by existing prescribed benchmarks, with eligibility determined prospectively and supported by clear safeguards to preserve the integrity of the performance test.

3. How could this new covered asset class be designed? In particular:

3.1. How should eligible asset types be determined? What criteria could apply?

3.5. What other safeguards should apply, and why?

Eligibility for the emerging covered asset class should be principles-based rather than overly prescriptive. This will ensure the framework can accommodate new and developing asset classes as markets evolve, while maintaining appropriate safeguards against gaming.

An asset should only be eligible where the trustee can demonstrate that:

- the asset is not appropriately captured by an existing prescribed benchmark;
- there is no suitable market index that is sufficiently mature, representative, transparent and investable;
- the asset has risk and return characteristics that are materially different from existing covered asset classes;
- the investment is made in accordance with the trustee's best financial interests duty and broader investment governance obligations; and
- where relevant, the asset reflects forward-looking investment characteristics (such as exposure to transition-related or nature-related opportunities) that are not well captured by traditional benchmark indices.

Eligible assets could include emerging or alternative asset classes such as venture capital, early-stage energy transition assets, social and affordable housing, farmland, timberland and other natural capital assets. These assets can provide diversification, inflation protection or long-term return benefits, but may not be well matched to listed market benchmarks or existing alternatives benchmarks. These assets include those that play a key role in facilitating the economy-wide transition to net zero, reinforcing the importance of a framework that can accommodate their distinct risk-return characteristics.

The category should not become a broad residual bucket for any asset that creates tracking error against the current test. Where an existing benchmark can be improved or a more suitable benchmark can be introduced, that should be considered through the routine benchmark review process. The emerging asset class should be reserved for assets where a fit-for-purpose benchmark does not yet exist.

The key safeguards should be prospective application, guidance, trustee documentation, auditability and ongoing monitoring. Trustees should be required to document why an asset has been allocated to the CPI+X covered asset class, why no existing benchmark is appropriate and how the allocation is consistent with the trustee's investment governance obligations and best financial interests duty. APRA should monitor use of the category through reporting and the routine benchmark review process to ensure it is being applied consistently with its intended purpose.

RECOMMENDATION 3.2

Eligibility for the CPI+X covered asset class should be principles-based, prospective and limited to assets that are not appropriately captured by existing benchmarks, with safeguards delivered through guidance, trustee documentation and ongoing monitoring.

3.2. How should the CPI + X target be set?

3.3. Should different targets apply to growth and defensive assets?

APRA is best placed to set the CPI+X targets because it administers the performance test, receives detailed returns and asset allocation data from trustees, and has visibility over how different asset classes are performing across the system.

The targets should be set centrally and calibrated on a long-term basis. They should not move frequently in response to short-term market conditions, as this would risk shifting the goalposts after trustees have made long-term allocation decisions. This is particularly important for emerging and alternative assets, where investment timeframes are often long and returns may emerge over a full investment cycle rather than over shorter market periods.

The FSC supports a framework grounded in finance theory. The target should reflect a long-term real return hurdle, with the margin above CPI informed by a real cash rate assumption and an appropriate risk premium. Defensive assets should have a lower hurdle, reflecting more stable income, lower equity beta, stronger contractual cashflows or lower development risk. Growth assets should have a higher hurdle, reflecting greater exposure to capital growth, development risk, illiquidity risk and broader market risk.

The FSC supports separate targets for growth and defensive assets. As a starting point, CPI+3 per cent for growth assets and CPI+1 per cent for defensive assets appear broadly reasonable. These settings would provide a meaningful performance hurdle while recognising that materially different assets should not be forced into the same return target.

APRA should provide guidance on the principles used to classify assets as growth or defensive. Relevant factors could include:

- the asset's expected source of return, including whether returns are primarily generated through income, contracted cashflows, capital growth or valuation uplift;
- the extent of equity beta or market risk embedded in the asset;
- the level of development, construction, leasing, operating or commercialisation risk;
- the degree of contractual, regulated, subsidy-backed or otherwise predictable cashflows;

- the asset's liquidity profile and valuation frequency;
- the expected volatility and downside risk of the asset;
- the role of the asset in the portfolio, including whether it is held primarily for return generation, diversification, inflation protection, income stability or downside protection; and
- whether the asset is in a development, ramp-up or stabilised operating phase.

For example, a contracted, subsidy-supported social housing exposure would generally be more likely to be treated as defensive than a development-stage renewable energy project or an early-stage venture capital exposure. Similarly, an asset may move between growth and defensive treatment over its lifecycle, such as where a development-stage infrastructure or real estate asset becomes a stabilised operating asset with contracted cashflows.

How the framework applies to assets with a development or J-curve return profile should be tailored. For these assets, early-year returns may be weak or negative while capital is deployed, assets are developed, operations are scaled or exits are realised. This means early performance may not reflect the expected long-term return profile of the investment.

The FSC considers these assets should still be reported to APRA and measured against the relevant CPI+X benchmark during the development period. However, where a trustee can demonstrate that an asset has a clearly documented development or J-curve profile, APRA should allow a time-limited period before the asset is included in the overall pass/fail performance assessment. This treatment should be subject to appropriate safeguards, including trustee documentation of the expected development period, pathway to stabilisation or exit, and consistency with the trustee's investment governance obligations and best financial interests duty.

The X component should be reviewed every 10 years as the target is intended to reflect long-term expected returns and should align with the long-term horizon of the performance test. More frequent recalibration would create uncertainty and could undermine the purpose of introducing a stable benchmark for emerging and alternative assets.

A shorter review cycle should only apply where there is a material change in market structure, the availability of a suitable market index, or clear evidence that the target is no longer operating as intended. APRA should still monitor use of the CPI+X category through regular reporting, but the X margin itself should remain stable unless a change is clearly warranted.

RECOMMENDATION 3.3

APRA should set separate CPI+X targets for growth and defensive assets, calibrated on a long-term basis using a real cash rate assumption and appropriate risk premia. As a starting point, APRA could consider CPI+3 per cent for growth assets and CPI+1 per cent for defensive assets.

RECOMMENDATION 3.4

APRA should provide principles-based guidance on the classification of growth and defensive assets, recognising the asset's source of return, market risk, development risk, cashflow profile, portfolio role and lifecycle stage. The X component should be reviewed every 10 years, or earlier only where clearly warranted.

RECOMMENDATION 3.5

The treatment of assets with a development or J-curve return profile should be tailored, including allowing these assets to be reported against the relevant CPI+X benchmark but excluded from the overall pass/fail performance assessment for a time-limited development period, such as three years, where appropriately justified by the trustee.

3.4. What allocation cap should apply, and why?

The FSC supports a 10 per cent allocation cap for the emerging covered asset class as a backstop safeguard.

FSC members consider that a 10 per cent cap would strike the right balance between preserving the integrity of the performance test and avoiding unnecessary constraints on legitimate trustee investment decisions. Members have indicated that allocations to these types of emerging and alternative assets would generally not be expected to exceed 10 per cent of a product's strategic asset allocation. On that basis, a 10 per cent cap would operate as a practical safeguard against inappropriate or excessive use of the CPI+X covered asset class, without materially limiting the ability of trustees to invest in assets that are in members' best financial interests.

A lower cap could be unnecessarily restrictive, particularly where emerging or alternative assets form part of a well-diversified investment strategy and are not appropriately captured by existing benchmarks. It could also require trustees to choose between otherwise appropriate assets solely because of performance test settings.

The cap should apply only to the proportion of a product's strategic asset allocation that is assessed through the CPI+X framework for performance test purposes. It should not apply to alternative assets that remain appropriately assessed under the existing Alternatives framework. The cap should also not prevent trustees from investing more than 10 per cent in relevant assets where this is consistent with members' best financial interests. Rather, any allocation above the cap should be attributed to the most appropriate existing covered asset class for performance test purposes.

The cap should operate alongside clear eligibility principles. Trustees should be required to demonstrate that the relevant asset is not appropriately captured by an existing benchmark, that no suitable mature and representative index is available, and that the allocation is consistent with the trustee's investment governance obligations and best financial interests duty.

RECOMMENDATION 3.6

The CPI+X covered asset class should be subject to a 10 per cent allocation cap for performance test purposes, operating as a backstop safeguard that limits excessive use of the category without unnecessarily restricting trustee investment decisions.

4. What are the key implementation and transition considerations for this option?

Implementation should prioritise regulatory certainty, prospective application and clear guidance.

The emerging covered asset class should apply on a go-forward basis only. Trustees should not be able to reclassify historical allocations to improve past performance test outcomes.

APRA should issue guidance before commencement on eligibility, reporting, documentation and the distinction between growth and defensive assets. A minimum 12-month transition period should apply after the rules and guidance are finalised.

This option would be materially simpler and less costly than replacing the test with a simple reference portfolio, as it retains the existing strategic asset allocation framework and adds a targeted mechanism for assets not appropriately captured by existing benchmarks.

APRA should monitor use of the emerging covered asset class to ensure it is applied consistently with its intended purpose. The X component should only be recalibrated every 10 years, or earlier where clearly warranted.

RECOMMENDATION 3.7

Apply the CPI+X covered asset class prospectively, with APRA guidance and at least 12 months' transition before commencement.

Improve the existing Alternatives covered asset class (Option 1.2)

5. To what extent would improving the Alternatives covered asset class address investment constraints the test may impose? Provide evidence or examples to support your views.

7. What are the key implementation and transition considerations for this option?

The FSC considers that the existing Alternatives covered asset class should be refined to better address investment constraints created by the current test.

The current Alternatives benchmarks are still linked to listed equity and fixed income markets. This can work for some alternative strategies, particularly where returns are materially influenced by listed equity or fixed income beta. However, it does not work well for all alternative assets.

Some alternative assets are not designed to track, or outperform, listed market benchmarks. They may be included in portfolios to provide diversification, downside protection, inflation protection, income stability or low correlation to traditional markets. For these assets, a listed market-linked benchmark can create artificial tracking error and may discourage otherwise appropriate investment.

This issue can arise for defensive alternatives, some hedge funds and liquid alternatives, private credit, farmland, timberland, natural capital and other assets whose return profile is not well reflected by listed equity or fixed income benchmarks.

The FSC does not consider that all alternative assets should automatically move to a CPI+X benchmark. Some alternative strategies may remain appropriately assessed under the existing

Alternatives framework, or a refined version of that framework, where their return drivers are sufficiently linked to listed markets.

A more targeted approach is therefore required. Alternative assets that are not appropriately captured by the current Alternatives benchmarks should be able to use a CPI+X pathway. Existing Alternatives treatment should be retained where it remains suitable.

This would recognise that alternatives are not a single homogeneous asset class. It would also avoid forcing all alternative assets into either a listed market-linked benchmark or a CPI+X benchmark where one may be more appropriate than the other.

Trustees should be required to demonstrate why an asset is more appropriately assessed through the CPI+X pathway. This should include evidence that the asset is not appropriately captured by existing benchmarks, that no suitable mature and representative index is available, and that the allocation is consistent with the trustee's investment governance obligations and best financial interests duty.

Implementation should be prospective and supported by APRA guidance on classification, reporting and the distinction between growth and defensive alternatives.

RECOMMENDATION 3.8

Introduce a targeted CPI+X pathway for alternative assets that are not appropriately captured by the current Alternatives benchmarks, with separate growth and defensive hurdles, while retaining the existing Alternatives treatment where it remains suitable.

4. Introduce an assessment of risk-adjusted returns (Option 2)

8. To what extent would introducing a simple reference portfolio address investment constraints the test may impose? Provide evidence or examples to support your views.

9. How could the simple reference portfolio be designed? In particular:

9.2. Is volatility an appropriate proxy for risk? If not, is there an alternative approach?

10. What are the key implementation and transition considerations for this option?

The FSC does not support replacing the current strategic asset allocation benchmark framework with a simple reference portfolio test.

While this approach may be intended to reduce benchmark hugging and provide greater flexibility for assets that are not well represented by the current benchmarks, it would effectively establish a new performance test with new investment incentives. Trustees would need to reassess investment strategies, risk budgets and governance frameworks against a new set of test objectives. This may simply replace the current incentive to manage to prescribed asset class benchmarks with an incentive to manage to the simple reference portfolio.

A simple reference portfolio would also create a new form of herding risk. Trustees may be incentivised to adjust portfolios towards the reference portfolio to reduce performance test risk, rather than construct portfolios based on their assessment of members' best financial interests. This could reduce portfolio diversity across the system and create new distortions in capital allocation.

The FSC is also concerned that a simple reference portfolio would be less neutral than it may appear. The test would rely heavily on listed market benchmarks, which can themselves be concentrated in particular sectors, securities or market themes. For example, Australian listed equity benchmarks can have significant exposure to banks and resources, while global listed equity benchmarks can be heavily influenced by a small number of large technology companies. This could embed new distortions into the test by assessing diversified portfolios against listed market indices that do not necessarily reflect the risk, return or diversification characteristics of the underlying portfolio.

Transitioning to a new test would also impose material costs. This would include regulatory implementation costs, system and reporting changes, portfolio rebalancing, transaction costs, spreads, liquidity impacts and potential tax consequences from buying and selling assets. FSC members estimate that the transition and implementation costs associated with moving to a simple reference portfolio test could be up to 10 basis points, with costs ultimately borne by members.

These costs would be particularly difficult to justify where the policy objectives can be achieved through more targeted changes to the existing framework. The FSC considers that targeted benchmark improvements, a routine benchmark review and a carefully designed emerging and alternative asset class benchmark are more appropriate than replacing the current test.

Volatility as a proxy for risk

The FSC does not consider volatility to be an appropriate standalone proxy for risk in the performance test.

Volatility captures only one dimension of investment risk and does not adequately reflect other risks relevant to member outcomes, including liquidity risk, valuation risk, concentration risk, sequencing risk, leverage risk and downside risk. Volatility also does not distinguish between upside and downside movements. A product with strong positive returns and higher upside volatility could be treated as higher risk, even where that outcome benefits members.

A volatility-based approach is particularly problematic for unlisted assets. These assets are valued less frequently than listed assets and their reported volatility can be materially affected by valuation frequency, valuation methodology and smoothing. This means a volatility-based test may not measure the underlying risk of the asset, but instead reflect how often the asset is valued and how valuation movements are recognised.

A further risk is that a volatility-based test could create incentives for trustees to increase allocations to assets with lower observed volatility, including illiquid private market assets. While these assets can play an important role in long-term portfolio construction, excessive allocation could create liquidity management challenges, particularly as the superannuation system matures and member drawdowns increase with an ageing population. A test that rewards lower observed volatility without adequately recognising liquidity risk could therefore encourage portfolio settings that appear lower risk under the test but are less resilient under stressed liquidity conditions.

Any attempt to adjust for this through de-smoothing would introduce further complexity and judgement. Different de-smoothing methodologies could produce materially different outcomes, creating uncertainty for trustees and reducing the objectivity of the test. This would be inconsistent with the objective of maintaining a clear and credible performance test.

A volatility-based test could also create unintended investment incentives. It may encourage trustees towards assets with lower observed volatility, rather than assets with stronger long-term expected returns, appropriate liquidity characteristics or better diversification benefits. Conversely, it may discourage investments with higher short-term volatility but strong long-term expected returns, including growth assets and some private market investments.

Growth and defensive classification issues

The FSC also has concerns with using a growth and defensive split as an alternative proxy for risk. While this approach may appear simpler than a volatility-based frontier, it would require subjective judgements about how assets should be classified and could produce outcomes that do not reflect the underlying risk and return characteristics of assets.

These issues are already apparent in APRA's *Comprehensive Product Performance Package*. For example, fixed income, including investment grade credit, can be treated as having a material growth allocation despite credit being a core component of diversified fixed income portfolios. The CPPP currently classifies fixed income, including credit, as 25 per cent growth and 75 per cent defensive, which materially overstates the risk and expected return of common fixed income benchmarks, including the *Bloomberg Ausbond Composite and Bloomberg Global Aggregate Bond Index*. Removing credit from the defensive simple reference portfolio would also exclude around one third of global bond capital markets, or approximately US$25 trillion, and remove credit premia as a source of return.

This illustrates the broader problem with relying on growth and defensive classifications as a test design. Assets such as infrastructure, private credit, property, alternatives and some multi-asset strategies can have characteristics of both growth and defensive assets, depending on their structure, liquidity, leverage, contractual cashflows, development risk and role in the portfolio. A simplified classification approach may therefore misstate risk and create incentives for trustees to restructure or report exposures in ways that reduce test risk rather than improve member outcomes.

For example, separating a diversified bond allocation into government bond and credit components may reduce the reported growth classification, but could increase turnover costs, tracking error and reduce tax efficiency compared with managing the exposure against a market-cap weighted benchmark. This would be a poor policy outcome if the test encouraged portfolio construction changes for classification reasons rather than investment merit.

These issues demonstrate why the FSC considers targeted improvements to the existing benchmark framework are preferable to replacing the test with a simple reference portfolio based on volatility or growth and defensive classifications.

RECOMMENDATION 4.1

The current strategic asset allocation benchmark framework should not be replaced with a simple reference portfolio test, given the significant design, transition and implementation risks. Targeted benchmark improvements are a more proportionate way to address investment constraints while preserving the integrity of the performance test.

5. Introduce a routine review of the benchmarks (Option 3)

Supporting an adaptive benchmark framework

11. Would introducing a routine review support the ongoing effectiveness of the benchmarks? Provide evidence or examples to support your views.

The FSC supports introducing a routine review of the benchmarks used in the performance test.

A routine review would help ensure the benchmark framework remains fit for purpose as investment markets evolve, new asset classes mature and better data becomes available. This would support the ongoing effectiveness of the test by allowing targeted updates to the existing benchmark framework, rather than requiring more substantial changes to the design of the test. Any additions or changes to benchmarks should apply prospectively to preserve regulatory certainty and avoid retrospectively changing the basis on which trustee investment decisions were made.

The review should be guided by clear principles rather than a fixed list of asset classes. The benchmark framework should recognise asset classes at the level trustees and asset allocators make investment decisions, where there is a distinct risk and return profile, sufficient market depth, reliable data and a suitable representative benchmark. This would allow the review to respond to specific benchmark gaps identified today, while also ensuring the framework can adapt as new investment markets develop. Additionally, as the ASX is carbon heavy, and there are Australian funds and products that are looking to decarbonise, a benchmark review that incorporates a carbon emissions comparison, for example a Paris-aligned index, can help address this gap.

There are several areas where benchmark settings may need to be revisited over time. For example, small cap equities form a meaningful part of Australian and international equity markets but can create tracking error against broader equity indices. The inclusion of distinct small cap equity benchmarks could support greater diversification and reduce the risk that trustees are discouraged from investing in these asset classes due to performance test risk. Similar issues may arise for emerging markets, Australian credit, global credit, infrastructure, international real estate, agriculture and natural capital where existing benchmarks may not reflect the way trustees allocate capital or the role these assets play in a diversified portfolio.

The review should also recognise that not all assets are held primarily for expected return. Some assets, including certain alternatives, commodities, gold and other diversifying assets, may be held for diversification, inflation protection, downside protection or low correlation to traditional markets. Benchmark settings should be capable of reflecting the role of these assets in a diversified portfolio, rather than assuming all asset classes should be assessed only against a return-seeking framework.

A routine review would also provide a structured pathway for considering emerging benchmarks once they have sufficient maturity, coverage and market acceptance. For example, farmland, timberland and other natural capital assets are not currently well reflected in the existing benchmarks. The ANREV Australian Farmland Index may not be appropriate for inclusion in the test at this stage due to size and maturity, but could become suitable in future years as its data set and market coverage mature.

The routine benchmark review should also provide a pathway for assets initially treated under a CPI+X framework to transition to a market benchmark where the asset class becomes sufficiently mature. This would ensure the CPI+X pathway operates as a targeted mechanism for assets that are not yet well served by market benchmarks, while allowing the framework to evolve as suitable indices develop.

The FSC supports a three-yearly review cycle. This would provide an appropriate balance between maintaining stability in the test and ensuring the benchmarks can be updated where there is clear evidence that existing settings are no longer appropriate or that better benchmarks have become available. Any benchmark changes should apply prospectively and be supported by appropriate transition arrangements.

RECOMMENDATION 5.1

Introduce a formal three-yearly review of the performance test benchmarks to ensure they remain fit for purpose and can be updated prospectively as markets evolve and suitable new benchmarks become available.

12. How could a routine review of the benchmarks be designed? In particular:

12.1. What issues should be within scope of the review, and why?

12.2. Who should be responsible for conducting the review, and why?

12.3. How frequently should the review occur, and why?

13. How should the benchmarks be specified and updated over time?

The FSC supports a three-yearly review of the benchmarks used in the performance test.

The review should consider whether existing benchmarks remain appropriate and whether new benchmarks should be added to better reflect the risk and return characteristics of assets in which trustees are investing. This should include consideration of benchmark gaps for asset classes where the current benchmark framework may not adequately reflect the underlying risk and return characteristics of the investment, including sub-investment grade fixed income, infrastructure, international real estate, hedge funds and liquid alternatives. This should include whether benchmarks remain representative, transparent, investable, cost-effective and supported by sufficient data history.

The review should be led by APRA, with Treasury retaining responsibility for broader policy settings. APRA administers the test, receives asset allocation data from trustees and is closer to how the test operates in practice. This means APRA is well placed to identify where benchmarks may be creating unintended tracking error or where new asset types warrant consideration.

APRA's review should be supported by structured industry consultation, including with superannuation trustees, investment managers, asset consultants, platforms, managed account providers and index providers. This would help ensure benchmark changes are informed by practical implementation issues, data availability, product design and the way different assets are used in member portfolios.

To support this, the Government should consider moving the prescribed benchmarks from the regulations into a more flexible legislative instrument, such as an APRA-administered instrument. This would allow technical benchmark updates to be made more efficiently, following consultation, while reducing the need for the Treasurer to progress minor benchmark changes through regulation.

A three-yearly review cycle would balance stability with flexibility. Benchmark changes would not need to be made at every review, but a regular process would give industry a clear opportunity to raise emerging asset classes, benchmark concerns and new index developments.

RECOMMENDATION 5.2

Amend the performance test framework to enable APRA to specify the prescribed benchmarks through an APRA-administered legislative instrument, with APRA responsible for undertaking a three-yearly benchmark review and consulting on any prospective benchmark updates.

Customised benchmarks for sustainability and values-based strategies

The routine benchmark review should also consider how the performance test applies to products with clearly disclosed sustainability, values-based or climate-transition objectives.

These products may intentionally differ from standard market-capitalisation benchmarks because of the investment strategy members have chosen. For example, a sustainable or values-based option may exclude fossil fuels, gambling or weapons, underweight high-carbon sectors, apply positive sustainability tilts or allocate to impact investments. These differences can create structural tracking error against the standard benchmark.

This is different from ordinary active management risk. For a conventional active manager, tracking error can generally be reduced by moving closer to the market-capitalisation benchmark. For a sustainability or values-based strategy, reducing tracking error may require diluting or abandoning the product's disclosed investment objective and the preferences members have selected the product to reflect.

The current test may also favour some sustainability approaches over others. A trustee can engage with a company and vote on shareholder resolutions without changing the product's exposure to the standard benchmark. However, if the trustee decides that engagement has not been effective and divests from that company or sector, the product may move away from the benchmark and face greater performance test risk. This means the test can penalise the investment action that gives effect to the product's disclosed sustainability or values-based objective, even where that action is consistent with member preferences.

A targeted response would be to allow, where appropriate, a customised benchmark that reflects the product's disclosed sustainability or values-based objective. This could include adjusting the benchmark to reflect relevant exclusions, positive tilts or the product's stated investable universe. The objective should be to assess whether the trustee has implemented the stated strategy effectively, rather than requiring the product to be measured against exposures it has deliberately excluded.

This approach should be subject to clear safeguards. The sustainability or values-based objective should be clearly disclosed in the PDS, the benchmark should be determined prospectively, and the customised benchmark should be subject to independent verification and APRA oversight. This would improve benchmark accuracy while preserving accountability and the integrity of the test.

RECOMMENDATION 5.3

Allow products with clearly disclosed sustainability, values-based or climate-transition objectives to use a customised benchmark where the standard benchmark does not reflect the product's stated investable universe, subject to prospective application, independent verification and APRA oversight.

14. What are the key implementation and transition considerations for this option?

Implementation should prioritise regulatory certainty, appropriate consultation and prospective application of any benchmark changes.

Any changes to benchmarks should only apply on a go-forward basis. Trustees make long-term investment decisions based on the benchmarks in place at the time, and retrospective changes would undermine confidence in the test and could unfairly affect products based on past investment decisions.

APRA should consult with industry before making any benchmark changes, including on the suitability of any proposed index, data availability, implementation costs, reporting implications and whether appropriate transition arrangements are required.

Changes should also be timed to avoid unnecessary disruption to the annual performance test cycle. Trustees should be given sufficient notice to update systems, reporting processes and investment governance frameworks before any new benchmark is applied.

Cost and accessibility of prescribed benchmark indices

15. What other issues with the benchmarks could warrant consideration, either as part of a regular review, or more broadly?

A broader issue with the current benchmark framework is the cost and accessibility of prescribed benchmark indices.

The performance test prescribes specific commercial indices that trustees need to access to assess performance, manage performance test risk and understand how their products are tracking against the test. This can create monopolistic pricing dynamics, as trustees have limited practical choice but to obtain the relevant index data from the provider whose benchmark has been prescribed.

This is a current issue with how the performance test operates. FSC members have previously raised concerns that some prescribed index data can cost in excess of US$50,000. These costs are ultimately borne by members and can increase as more benchmarks are added to the test.

The Government should consider options to reduce these costs while preserving the integrity of the test. This could include negotiating with index providers on minimum publication requirements and reasonable pricing for access to index values and methodology, with constituent-level data only required where necessary for implementation. Given the indices are being prescribed to support a public policy objective, there is a stronger case for Government involvement in ensuring they are available on reasonable terms.

The Government could also consider whether some covered asset classes should have more than one approved benchmark, allowing trustees to nominate the most appropriate benchmark to APRA on a prospective basis. This could introduce greater competition and reduce reliance on a single commercial provider, while maintaining objectivity if appropriate safeguards are in place. Any such model would need to consider how often trustees could change nominated benchmarks and how to prevent changes being made to improve test outcomes retrospectively.

The Government should also consider seeking advice from the ACCC on options to address monopoly pricing risks created by prescribing specific commercial indices in the performance test.

RECOMMENDATION 5.4

Assess options to address the cost and accessibility issues created by prescribed benchmark indices, including publication requirements, reasonable pricing arrangements, alternative approved benchmarks and potential ACCC advice.