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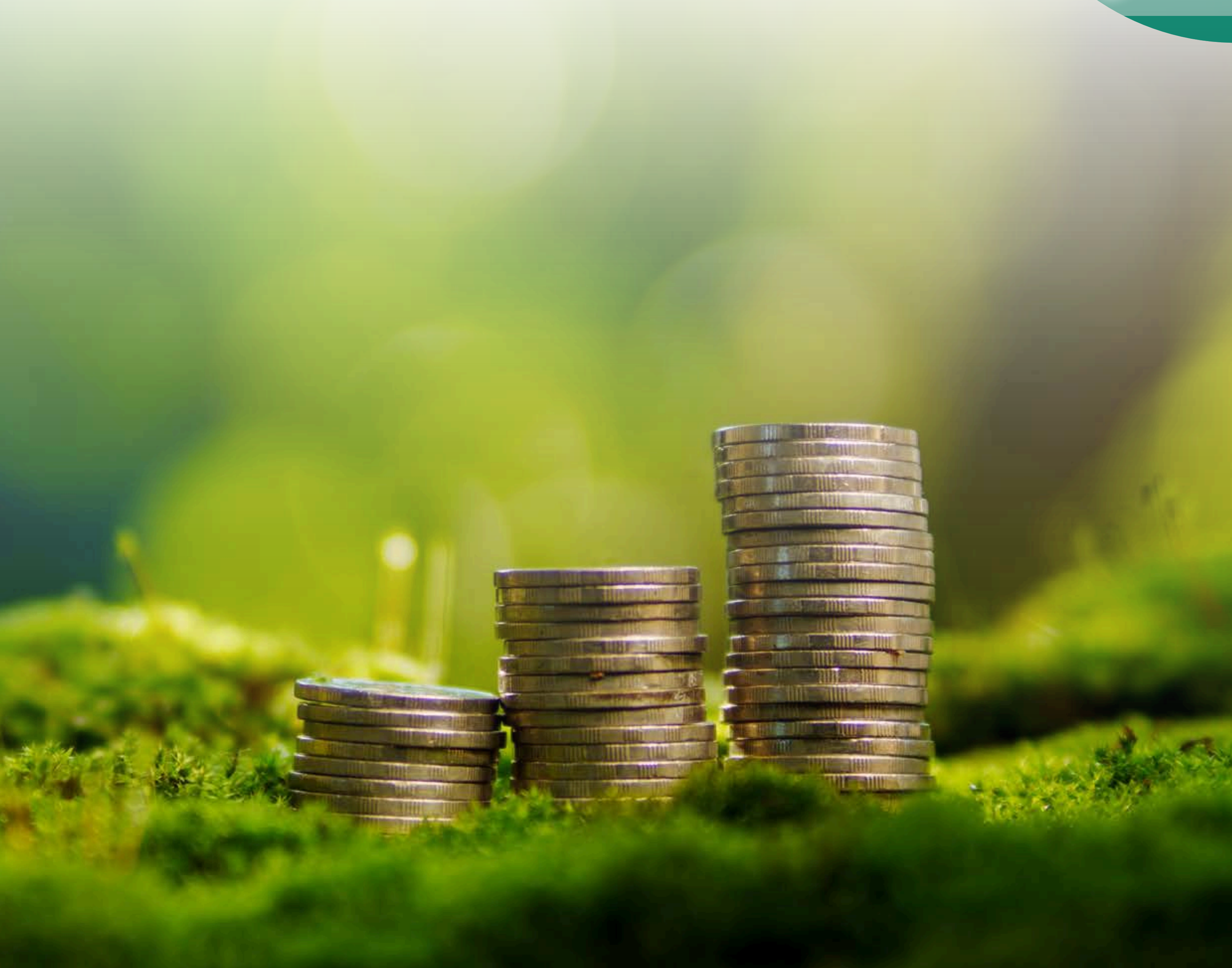

TRANSFORMING ESG CHALLENGES INTO OPPORTUNITIES:

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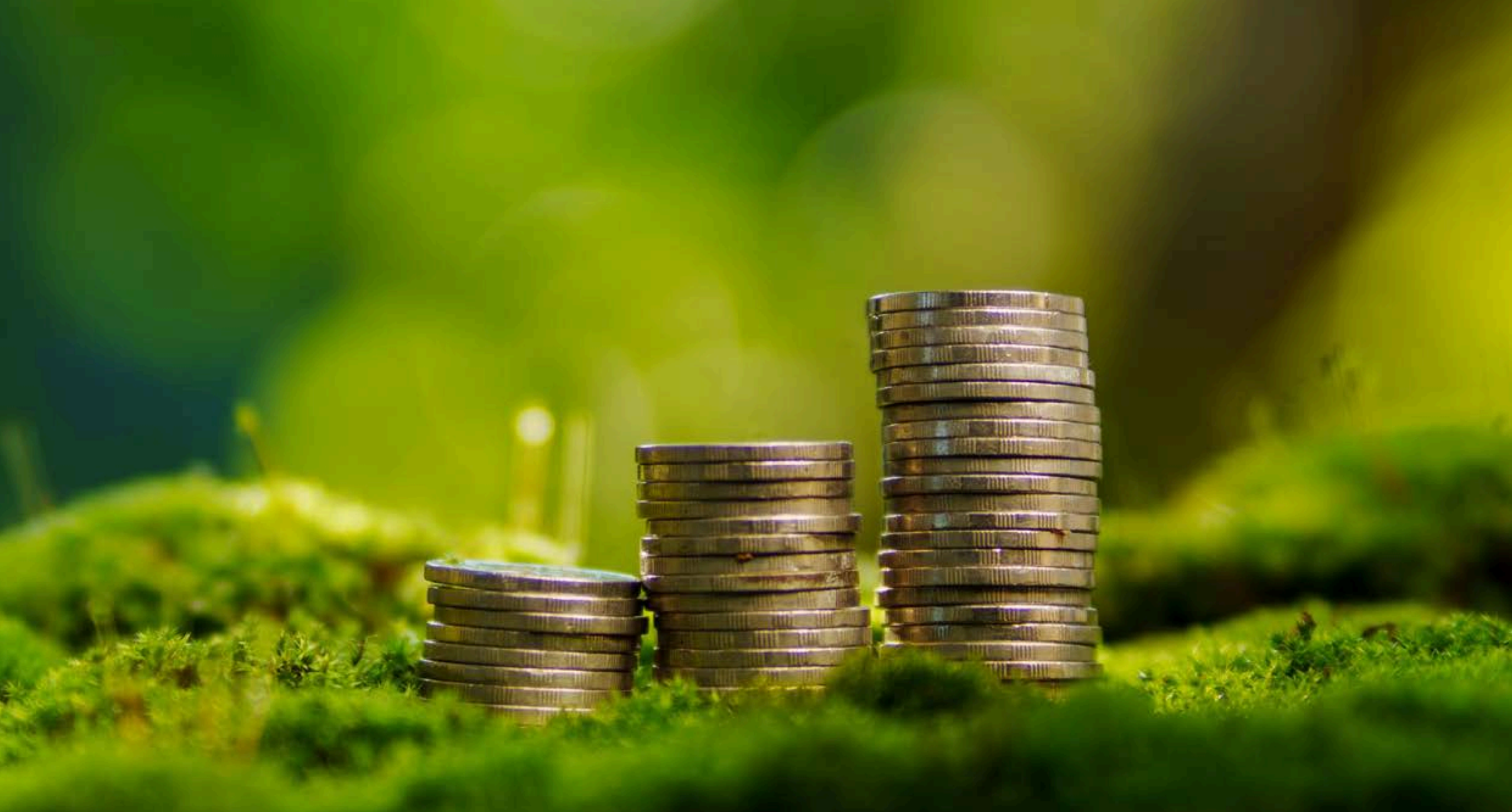

Transforming ESG challenges into opportunities: Strategy, risk mitigation and data management

By Oceanic Consulting Group

As the regulatory landscape for ESG (Environmental, Social, and Governance) intensifies across the financial services industry, organisations can benefit from a strategic approach that moves away from merely matching compliance with emerging regulations. ESG offers a source of new growth if associated challenges and unprecedented risks are managed. Firms need to consider how to create a competitive advantage through adaptive change. Effective risk mitigation targets the necessary but complex uplift of interconnected processes and policies for ESG strategy. Data management governance and tools provide the critical evidential backbone, supporting firms in their meaningful delivery of ESG strategic targets. With the trend of ESG only accelerating, how might organisations create new strategic growth through effective risk mitigation and data management?

A comprehensive ESG strategy requires a complex and multi-faceted transition that can seem bewildering for even the most battle-hardened executives. That said, today ESG progress distinguishes industry participants and flying under the radar is not sufficient.

As ESG preferences maintain significant momentum, it's never been more important to remain relevant to customer preferences and stay ahead of regulatory expectations. The corporate social responsibility standards of financial services are becoming more stringent, and firms are called on to re-evaluate their value. These growing expectations, and the varying responses across the industry, bridge a notable gap. This ESG gap represents a critical differentiation that sees some firms steam ahead and others left behind.

To respond to the growing ESG demand, firms need to pragmatically consider strategic integration whilst continuing to mitigate inherent risks. The focus on the 'E' (Environmental) and the 'S' (Social) in ESG is where we hear businesses, politicians and advocates most banging the drum – they are popular, and people like to talk about the good things they have done. A fully considered ESG strategy however, requires particular attention to the implications of Governance, or the 'G'.

The financial services industry has firmly embedded strong governance and risk oversight into its culture, meeting higher expectations. The adoption of governance operating models has become standard practice, ensuring consistent board oversight and effective management execution across the sector. For boards and managers, governance provides the crucial internal structures to manage risks effectively, comply with regulations, and align operations with broader societal expectations. For customers, asset managers and regulators, governance provides reassurance of proper oversight and operational implementation. Organisations' strategic objectives should consistently align with frontline operations and business decisions. For ESG strategy, effective governance ensures a compliant and meaningful ESG transformation.

Poor governance structure can be harmful to a company's reputation and potentially lead to enforcement action. Recent examples of ESG specific governance misconduct include insufficient disclosure of ESG investment methodologies, underlying investments inconsistent with ESG policy and unsubstantiated sustainability claims. In the face of backlash against greenwashing, strong governance is essential for ensuring credible disclosure and stakeholder transparency.

Robust ESG data management is fundamental, due to the complexity, subjectivity, and frequent misinterpretation of ESG data. Data learning and approaches can be restrictive, but comparatively, enabling in this space.

On the topic of ESG data management James Dickson, Managing Director of OCG, said "Regulators expect firms to understand, validate and manage the quality of ESG data being consumed and reported for portfolio construction or reporting. Firms should not assume that even the most

household name data providers meet this standard, particularly across very broad indices or emerging markets, and need to be alive to the reality of this risk."

Informed decision making in ESG benefits from the utilisation of AI (Artificial Intelligence) and real-time information to enhance the systematic gathering and evaluation of publicly available information. Data aggregation technology provides financial services companies with the support to reconfigure these potentially ineffective data models. The advantage of these technologies in strategic ESG uplift is that they provide a single-source data record with the extra reinforcement of multi-sourcing and verification. For executives, ESG data management can sharpen market differentiation and benefit financial markets businesses, through mitigating discovery challenges and creating new growth. The 2017 Hayne Royal Commission left many lasting lessons for the financial services industry, including the critical importance of meticulous documentation. The collection, accuracy and access of historic records and data for financial advice was brought into sharp focus. For licensees, this precedent serves as a warning of the need to take documentation and data management seriously. Proper attention to data management prepares entities for regulator and auditor review, instilling appropriate data controls, lineage and governance for ESG confidence.

Recent regulatory updates point to escalating consumer and legislative sentiment towards ESG transformations in financial markets. On the 22nd of August 2024 the Senate passed legislation to enact Australia's mandatory climate related financial reporting, triggering significant change in ESG reporting processes under Section 4 of the Corporations Act. This recent progress reflects a policy projection in Australia alongside adoption of the first global sustainability reporting standard published by the International Sustainability Standards Board (ISSB) in June 2023. The Australian Securities and Investments Commission (ASIC) released their report on 'Interventions on Greenwashing Misconduct: 2023-2024' in August. ASIC's findings on Greenwashing reflect widespread intervention around the quality of disclosures and importantly – the data underpinning them. In relation to data management, ASIC Commissioner Kate O'Rourke said "Sustainability-related information, like any other, should be accurate, based on reasonable grounds and be easily understood by investors." Financial market participants are called to respond to evolving sustainability standards and ESG reporting requirements, an opportunity for decisive action but not without its risks.

By prioritising robust data management and effective risk mitigation, organisations can not only navigate the complexities of ESG compliance but leverage this capability as a driver of competitive advantage. As the regulatory landscape continues to evolve, those who proactively integrate ESG into their strategic objectives will be better positioned to excel in a market increasingly driven by sustainability. The time for action is now; by refining data management frameworks, bolstering governance structures, and addressing inherent risks, financial services firms can unlock new possibilities for growth and ensure a resilient future in an ESG-focused world.

How OCG can help

OCG assists financial services firms in managing ESG complexities through strategic partnerships, advanced technology, and robust data management, ensuring effective risk mitigation whilst creating new growth opportunities.

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Women often handle office 'housework,' impacting career growth and causing burnout. Powrsuit Co-founders Natalie Ferguson and Kristen Lunman will teach you how to professionally say 'no,' helping you focus on strategic work and providing actionable steps for your career.

Professional Standards CPD: Professionalism and ethics 1.0 hour
ASIC Knowledge Area: Generic knowledge 1.0 hour

Generating income with index-based strategies

Wednesday 23 October from 1.00 to 2.00pm AEST

JASON YE
S&P Dow Jones Indices

Jason Ye will discuss index-based strategies for income seekers, analysing various dividend and options indices. Learn how these strategies may enhance portfolio yield and manage risk in this essential webinar for optimising income-generating investments.

Professional Standards CPD: Technical competence 1.0 hour | **ASIC Knowledge Area:** Generic knowledge 1.0 hour

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Future of Private Wealth

Wednesday 13 November from 1.00 to 2.00pm AEST

MATT WALSH
Praemium

Praemium's Matt Walsh will present findings from their CoreData research on key trends in private wealth management, covering client experience, investment strategies, technology, and growth plans. Gain insights to help future-proof your business.

Professional Standards CPD: Technical competence 1.0 hour
ASIC Knowledge Area: Generic knowledge 0.83 hour

An update on AML/CTF rules

Wednesday 27 November from 1.00 to 2.00pm AEST

HONG-VIET NGUYEN
Ashurst

COREY MCHATTAN
Ashurst

Hong-Viet Nguyen and Corey McHattan will discuss recent and upcoming changes to AML and CTF practices in Australia, covering legislative updates, their impact on financial institutions, and practical steps for compliance and risk management.

Professional Standards CPD: Regulatory compliance and consumer protection 1.0 hour
ASIC Knowledge Area: Generic knowledge 0.83 hour

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Profitable international trading – it's all in the execution

By AUSIEX

The slump in global markets in early August 2024 is a reminder that inefficient execution has a real impact on offshore trading strategies, writes AUSIEX.

The S&P 500 and Nasdaq Composite Index can rise and fall significantly in a single session as Australians sleep, along with market darlings such as Apple (AAPL), Alphabet (GOOGL) and Tesla (TSLA).

Such volatility highlights an aspect of direct international stock trading that can be forgotten.

Investors should look at an international market intently before trading as there are differences in the way each exchange operates. The time difference with Australia is a crucial consideration for trading strategies.

There are a range of factors that can make a noticeable difference to the net outcome from a global equities portfolio.

FX considerations

Currency movements are an obvious consideration at all times. Multi-currency wallets can help advisers manage currency risk for clients by allowing them to maintain cash holdings in chosen denominations over time.

If an investor establishes a multi-currency wallet, they can use it to fund purchases and to place the proceeds of any share sales. It means they don't have to exchange currency every time they transact.

Dividends can also accumulate in the wallet, allowing advisers to be somewhat strategic in terms of precisely when to convert the foreign currency back into Australian dollars.

Investors who hold numerous wallets with different foreign currencies can also transfer cash between them after their initial purchase of foreign currency by using cross currency transactions.

Some platforms also send notifications to advisers using different wallets if there is a better currency to use for a specific transaction. The notification might simply say: "are you sure you want to use Hong Kong dollars for this transaction?".

Risk management and trading efficiencies through modern trading tech

Unlike Australia, not all global exchanges operate continually through their trading day. Hong Kong's HKEX, for instance, splits its daily trading into two sessions with a one-hour break for lunch at 12 pm (HKT).

Investors should be mindful of when markets are open to avoid placing orders or price discovery at a sub-optimal time. This is particularly relevant for Asian markets as they trade mostly in our afternoon.

Conditional orders or other trading triggers can be used to manage the risks of large market moves that may occur when other markets are open.

Using the various trigger-based order types now commonly available can also deliver operating efficiencies for advisers, who don't need to be working outside of domestic working hours to monitor price action and place trades.

It's possible for investors and their advisers to set triggers that generate a notification when a stock has moved by a certain amount. Or they can just automate trading – so if a client is holding Amazon and it goes down by 5% from a specified price, for example, it's sold automatically. These 'stop losses' can trail as well, with the 5% stop tracking the current price, which can prevent unnecessarily deep losses where there is price growth.

This type of execution risk management is really important for advisers and their clients to consider but can often be overlooked.

Consider extra market-specific costs and administration

Each global market has different costs that should be on advisers' radars. Canada, for example, charges brokerage on each share traded on a per cents basis. This is particularly pertinent to investors trading low value securities. For example, an order of 10,000 units of a penny dreadful would attract the charge on each of those units.

Other markets charge stamp duty. In the UK, for example, stamp duty may be applied on buy transactions at a rate of 0.5% of the transaction value.

Bureaucracy can also be a pain point for investors and advisers to negotiate before trading international shares directly. It's important to complete all relevant documentation in order to have the appropriate treaty tax rate applied for withholdings tax. The information collected via a W-8BEN form is crucial for US based transactions.

Know your market

Many parts of the world have more than one stock exchange, so advisers need to know if a broker provides access to those securities they wish to trade.

There are approximately 13 different exchanges in the US, as well as a number of different exchanges in Europe and the UK, and not all of them are readily accessible to Australian residents. There are also instruments listed in multiple places. Danish health company Novo Nordisk, which makes the highly publicised weight loss drugs Ozempic and Wegovy, is listed on Nasdaq Copenhagen (NOVO-B.CO) and on the New York Stock Exchange (NYSE: NVO) as American depositary receipts.

The pricing may be slightly different for such companies and there may be an additional element of foreign exchange depending on the market in which an adviser chooses to transact.

The overarching message is that investors consider the nuances of each market in which they trade before implementing an international trading strategy.

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Reforming Australia's AML/CTF regime and Tranche 2 expansion

By Manish Ghiya, Principal, Compliense Advisors

"The reforms in the Bill would ensure Australia's AML/CTF regime continues to effectively deter, detect and disrupt illicit financing, and protect Australian businesses from criminal exploitation." *Explanatory Statement to the Bill*

In a significant step, the Attorney General introduced the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Amendment Bill 2024 (Bill) into Parliament on 11 September 2024 to amend the AML/CTF Act 2006 (Act).

The Bill has come swiftly after the second consultation, signifying the Government's resolve to strengthen Australia's AML/CTF regime and "*minimise the risk of Australia being 'grey listed' by the FATF, which would result in significant economic and reputational costs.*"

The Bill aims to achieve the following:

- extend the AML/CTF regime to new higher-risk service providers (real estate professionals, professional service providers including lawyers, accountants, and trust and company service providers, and dealers in precious stones and metals – also known as 'tranche two' entities);
- improve the regime's effectiveness by making it simpler and clearer for businesses; and
- modernise the regime to reflect changing business structures, technologies and illicit financing methodologies.

Changes proposed

The Bill proposes significant changes across several areas of AML/CTF compliance, many of which will impact existing Reporting Entities (REs). Some of these changes are discussed below.

Risk assessment

This is an area of significant change for REs impacting their risk assessment exercise including its methodology, frequency, and governance. Undertaking a risk assessment is now an explicit obligation, and an RE cannot provide designated services without the relevant risk assessment.

As a new requirement, the risk assessment must also identify and assess risks in relation to Proliferation Financing (PF). This has further flow-on effects on the RE's AML/CTF policies. Unless the PF risks assessed are rated low and they can be appropriately managed by RE's AML/CTF policies, the RE must develop or maintain specific AML/CTF policies to mitigate and manage PF risk.

On a side note, PF relates to the conduct that breaches counter proliferation provisions under the Charter of UN Act or Australian Autonomous Sanctions in relation to the weapons of mass destruction.

The risk assessment must be appropriate to the nature, size and complexity of the RE's business. The RE must review its risk assessment for any changed or new risks of ML, TF and PF if there is a significant change to its designated services, products, customers, geography or technologies. The changes, if in control of the RE, must be updated before the change occurs. In any event, the risk assessment must be reviewed every three years and updated.

AML/CTF Program ('Program'), AML/CTF Policies ('Policies')

These two concepts broadly form the foundation of an RE's AML/CTF compliance framework.

The current obligation for AML/CTF programs to be structured in Part A and Part B, and the concepts of the standard, joint and special AML/CTF programs will be removed.

According to the Bill, the REs must have an AML/CTF program. It comprises the RE's ML/TF risk assessment and its AML/CTF policies. The AML/CTF program requirements will comprise a set of outcomes-focused obligations.

The AML/CTF policies are a suite of RE's policies, procedures, systems and controls to manage and mitigate ML, TF and PF risks; and ensure its AML/CTF framework is geared towards achieving compliance with the regulatory obligations.

The AML/CTF policies will also include a range of matters and methodologies, like how an RE will identify significant changes to trigger a review of its ML/TF risk assessment, conducting customer due diligence, and mechanism to review and update AML/CTF policies when required.

It should also articulate matters like informing RE's governing body of the ML/TF/PF risks; designating an AML/CTF compliance officer; designating a senior manager for approving the policies; risk assessments and changes in them; staff due diligence; staff training and awareness; and an independent review of its program at least once every three years.

In the case of a reporting group (discussed below), matters related to information sharing and discharging obligations between the group entities must also be part of the policies.

The policies must be reviewed at trigger events as per the AML/CTF Rules, and in any event every three years.

Customer due diligence (CDD)

This is another area of significant change. The Bill reframes and clarifies the requirements for CDD.

As part of the initial CDD, an RE must before providing designated services take reasonable steps to establish the customer's identity (and some related persons, like beneficial owner), ML/TF risk of the customer, collect the customer's KYC information appropriate to the ML/TF risk, and verify the customer information through independent and reliable data. In certain cases, the RE can provide designated services before undertaking initial CDD.

The Bill further provides for ongoing CDD; and applying simplified CDD in certain low ML/TF risk and non-enhanced CDD cases. ECDD will be necessary for high-risk customers or in certain described high-risk scenarios.

Reporting Group (Group)

The concept of the Designated Business Group is to be replaced with the simpler concept of a Reporting Group.

A Reporting Group is a business group with at least one entity providing designated services, and fulfilling requirements in the rules. It will have a 'lead entity' RE, responsible for implementing a group-wide AML/CTF program. The lead entity will also be responsible for developing the ML/TF risk assessment for the group.

The new concept applies a more flexible framework for related entities including non-REs that may fulfil AML/CTF obligations on behalf of the REs in a group.

Item 54 Providers

AFSL holders providing only designated services covered by Table 1 item 54 (e.g.: financial planners) in Section 6 of the Act will continue to retain their earlier exemption. They will be required only to undertake an ML/TF risk assessment and have AML/CTF policies directed at undertaking initial CDD.

AML Compliance Officer (AMLCO)

REs must designate an individual as an AMLCO, though the individual need not necessarily be an employee.

The AMLCO must be at the management level, and must also pass 'fit and proper' test prescribed by the rules.

The changes discussed above are proposed to take effect from 31 March 2026.

Other changes

The Bill also proposes changes in the areas of tipping-off, international electronic funds transfer instructions, oversight and governance by the RE's governing bodies, and the requirement to undertake independent review at least once every three years.

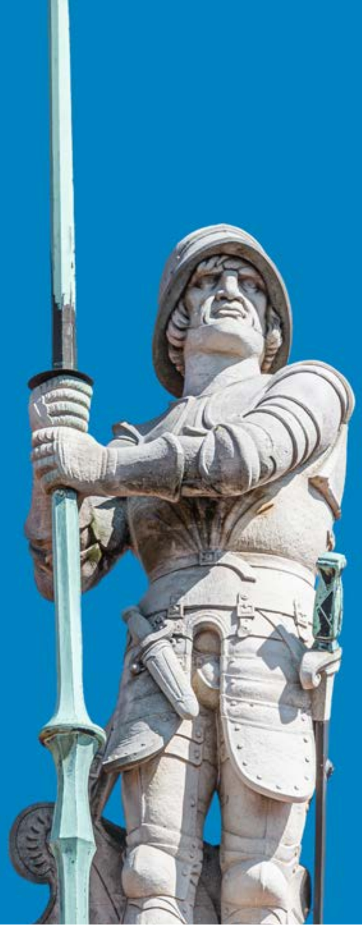
Next steps

The changes proposed by the Bill are likely to have a significant impact on the AML/CTF compliance programmes of the existing REs. Businesses must carefully consider the impact of the new provisions, and the rules when released by AUSTRAC, and suitably amend their AML/CTF compliance program.

Note: This article is for general informational purposes only and discusses a few key aspects regarding the subject it covers. It is not exhaustive and does not constitute a professional or legal advice. Please seek specific advice for your situation.

Compliense Advisors is an AML and FinCrime compliance and risk management advisory firm, and we can assist with your AML/CTF compliance obligations. Write to us at compliense@compliense.com.au. Visit our website for more knowledge resources, and signing up for new articles and updates.

The true cost of gatekeeper failures



By Calissa Aldridge, Executive Director, Markets, ASIC

Trading in the derivatives market is an exercise in risk management – putting a cost on volatility and uncertainty. However, not all risk can be traded away.

ASIC's Market Integrity Rules place certain obligations on market participants that can't be on sold in the same way that exposure to fluctuating commodity prices can.

In particular, the rules require market participants to prevent their clients from submitting orders in futures contracts when they suspect the order was placed to manipulate or mislead the market. This requires gatekeepers to have robust surveillance capabilities and systems for detecting, preventing, and disrupting suspicious trading.

These rules are an important safeguard that go to the heart of market integrity. Daily settlement prices can influence what Australians pay for electricity. In a cost-of-living crisis, failure to prevent this type of behaviour is particularly serious.

It's why all market participants should be on notice, following the Markets Disciplinary Panel's decision to issue the largest gatekeeper in the ASX 24 electricity futures market – Macquarie Bank – with a $4.955 million infringement notice.

This is the highest penalty ever imposed by the Markets Disciplinary Panel. Its severity reflects the gravity of the failures.

The Markets Disciplinary Panel found it had reasonable grounds to believe Macquarie breached Market Integrity Rules 50 times from January to September 2022, by allowing its clients to place orders which Macquarie ought to have reasonably suspected were intended to create a false or misleading appearance around the price of contracts in the ASX 24 electricity futures market.

All of the orders were placed within the final minute or seconds of market close and pushed the daily settlement price in a direction favourable to the client – a practice known as "marking the close".

The suspicious trading occurred at a time when Russia's invasion of Ukraine had caused supply chain shocks in the energy sector.

Global wholesale energy costs had soared, and Australians were already feeling cost of living pressures. ASIC had warned Macquarie of the heightened need to monitor the electricity derivatives market, given the volatile conditions.

The integrity of our financial markets relies on the vigilance of gatekeepers.

Gatekeepers occupy a unique vantage point to identify and limit misconduct that can damage the integrity of our markets and reverberate throughout our economy.

In times of volatility, gatekeepers must be alert to attempts to manipulate these markets – and be responsive to the concerns of regulators. In this case, Macquarie was neither.

Macquarie initially blamed the fault on a simple coding error in its third-party surveillance software, Nasdaq SMARTS.

Nasdaq had coded the close time for the ASX 24 futures market 30 minutes later than it was in reality, so the trades did not trigger any alerts.

However, Macquarie failed to identify and address this issue in a timely way – even when alerted to suspicious trading by ASIC.

When it comes to our markets, even errors which may seem small to some can have massive consequences.

It's why we have Market Integrity Rules – and why gatekeepers can't outsource their obligations under them.

Regardless of service delivery arrangements, the responsibility for compliance remains with the market participant.

Where there are failures – third party or otherwise – market participants are accountable.

Furthermore, they need to heed ASIC's alerts and respond promptly.

In 2024, we have had a dedicated enforcement focus on gatekeepers who facilitate misconduct.

The Markets Disciplinary Panel also issued a $775,000 infringement notice* to J.P. Morgan Securities Australia, following an ASIC investigation.

The panel found J.P. Morgan had failed to detect and prevent orders it ought to have suspected were intended to manipulate Eastern Australia Wheat futures contracts during the same period of volatility.

We have also commenced civil penalty proceedings against COFCO International Australia Pty Ltd and COFCO Resources SA, alleging the companies manipulated the ASX 24 market for Eastern Australia Wheat futures.

Over the coming year, our focus will extend to other products and markets, including debt markets and private markets.

As these markets expand, the role of gatekeepers will become even more important, particularly in markets where reduced transparency might be part of the appeal.

Recent analysis from ASIC shows Australia has some of the cleanest markets in the world, with a world-class reputation among companies and investors.

We want Australia to retain this reputation and remain a great place to invest, which is why we need gatekeepers to lift their game and maintain high standards.

Nearly $5 million might seem like a lot to pay for a coding error but what is market integrity worth?

*Both Macquarie and J.P. Morgan have complied with their respective infringement notices. Compliance with an infringement notice is not an admission of guilt or liability. In complying with the infringement notice, the recipient is not taken to have contravened subsection 798H(1) of the Act.

Learnings from US T+1

By Michelle Huckel, Policy Manager, SIAA

On 28 May 2024, the US securities market successfully moved to T+1 settlement for equities, corporate bonds, municipal bonds, unit investment trusts and financial instruments comprised of these securities.

Canada, Argentina, Mexico and Jamaica transitioned on 27 May (Peru transitioned on 28 May).

The T+1 After Action Report recently issued by the organisations that led the industry's efforts to plan, coordinate and implement the US transition[1] outlines the key issues that were central to the success of the project as well as highlighting important lessons for a potential move to T+1 in Australian markets.

In its recent consultation paper on Release 2 of the CHESS replacement system, ASX has proposed that an Australian T+1 go-live date be at least 12 months after the CHESS replacement Release 2 go-live, and at a minimum 18 months after a decision to transition to T+1. This would place an Australian T+1 transition at no earlier than 2030.

According to the T+1 After Action Report, this will be time well spent – as the US transition to T+1 settlement process took well over three years to complete and required a whole of industry effort to plan, coordinate and implement.

The journey to US T+1 go-live involved the following key milestones:

- A white paper was released in February 2021 by the DTCC that set the stage for increased industry discussions around the topic of T+1.
- By December 2021, ICI, SIFMA and the DTCC issued a joint white paper that provided significant momentum to the initiative and highlighted the benefits and considerations.
- Following the joint white paper an industry steering committee and multiple associated industry working groups were formed to analyse the impacts of T+1.
- In the summer of 2022, the three organisations published a playbook to serve as a framework and guide for impacted market participants.
- The US SEC adopted formal rule amendments in February 2023 and announced 28 May 2024 as the official transition date.
- The three organisations hosted workshops, webinars and established working groups to tackle the most challenging topics facing the industry as it prepared for a substantial compression of the post-execution timeframe.

Some of the key topics identified by the working groups were:

- securities lending and recall processing,
- enhancements to the allocation, confirmation and affirmation process,
- foreign exchange and cash management,
- primary and secondary ETF market processing,
- cross border securities.

Cross-border co-ordination was also required and several countries that were transitioning at the same time joined the industry sessions and the T+1 Industry Command Centre that was established to ensure a smooth conversion to T+1 settlement. The Command Centre operated from 24 to 31 May and served as a clearing house for issue identification and socialisation, and included various playbook updates, industry webinars, meetings, read-outs, testing report-outs and the development of industry consensus on proposed resolutions.

Regulators were briefed on industry transition progress before, during and post-implementation. A bridge-line was held open continuously for over 48 hours from 28 to 30 May as the industry worked through critical 'double settlement'[2] processing.

The After Action Report concludes that the Command Centre was critical to the success of go-live and was a key enabler of the smooth transition.

The success of the T+1 transition demonstrates the value of close coordination and collaboration in the industry with the participation of firms, market infrastructure providers and industry associations in the US and internationally and is a valuable learning for the Australian market.

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1 The Securities Industry and Financial Markets Association (SIFMA), Investment Company Institute (ICI), and The Depository Trust & Clearing Corporation (DTCC).

2 Trades from Friday 24 May (T+2 settlement) and Tuesday 28 May (T+1 settlement) settled on the same day (Wednesday 29 May) – which is referred to as 'double settlement day'. The US markets/settlement was closed on Monday 27 May (US Memorial Day).

Super funds pass muster

By Jason Spits, Senior Journalist, selfmanagedsuper

One of the key things that needs to be in place within a forced savings retirement funding system is being sure any vehicle consumers choose to hold and invest their money in is not only sound, but actually grows those sums yearly above a basic minimum benchmark.

Thankfully, in the Australian equivalent of the system described above – superannuation – we do have mandatory annual testing of the performance of every fund administered by the Australian Prudential Regulation Authority (APRA) that is open to retail members.

These tests are carried out by APRA using a benchmark portfolio that matches the asset allocation of the fund being tested. The benchmark is based on actual returns from each underlying index used in the same proportions within products and from this the prudential regulator calculates an expected return over a rolling 10-year period.

More importantly, fewer funds are failing the test each year since it was introduced in 2021, which is a positive development, but at the same time fewer products are being tested due to the drastic outcomes that follow two successive failures.

At this point, it is important to explain the annual superannuation performance test carried out by APRA initially covered MySuper products – default super funds offered by employers for staff who didn't have a fund or nominate one when commencing work – and that has continued to be the case since 2021.

In 2023, APRA expanded the scope of the test to include choice products, which are superannuation portfolios specifically chosen by fund members, and are referred to as trustee-directed

> "While the number of MySuper offerings failing the test has fallen to zero this year, the number of funds being tested has decreased from 80 in 2021 (when 13 of them failed the test) to 57 in 2024. At the same time, the number of TDPs has decreased from 805 last year, when the test first applied to them and 96 products failed, to 590 in 2024, when 37 funds failed, including 27 for the second time.

products (TDP) by the regulator as the fund trustee has control over the underlying investments.

While the number of MySuper offerings failing the test has fallen to zero this year, the number of funds being tested has decreased from 80 in 2021 (when 13 of them failed the test) to 57 in 2024. At the same time, the number of TDPs has decreased from 805 last year, when the test first applied to them and 96 products failed, to 590 in 2024, when 37 funds failed, including 27 for the second time.

It is this successive failure that has been partly responsible for the decrease in numbers as any superannuation product that fails the performance test twice is automatically closed to new members, and by extension new fund inflows, which has in some cases led to their total closure.

From a consumer perspective, all this is good news because the enviable reputation of the Australian retirement income system relies on more than just compulsory superannuation guarantee contributions that every employer makes and as more people move into retirement the ability to trust their fund to deliver will be paramount.

There is some criticism that a backward-looking test that closes off superannuation products to new members after two strikes is at odds with the oft-repeated statement that past performance is no indicator of future performance, and gives no chance for redemption.

However, APRA deputy chair Margaret Cole warned the superannuation sector that despite the good overall test results for 2024, that statement also meant the pressure was still on them to perform.

"These are pleasing results, but, as trustees well know, past performance is no guarantee of future success. Even based on existing performance, there is significant scope for improvement across key drivers of performance, including costs and fees, and investment returns," Cole said.

"We also note that trustee activity to eliminate underperforming products, through the consolidation, restructuring or withdrawal of investment offerings, has contributed to a sharp decrease in test failures by trustee-directed products."

For the moment the news is good for super fund members and while the overall number of products has declined, it is unlikely anyone will mourn the loss of funds that were unable to do what was required of them.

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