

16 November 2018

Productivity Commission
4 National Circuit
Barton ACT 2600

By email: super@pc.gov.au

To whom it may concern,

Investment performance: supplementary analysis

This submission is in response to the Productivity Commission's (PC) supplementary report on the topic of investment performance for Stage 3 of its inquiry into Superannuation: Assessing Efficiency and Competitiveness. The purpose of this submission is to comment on the analysis presented in the report, data and questions of fact rather than to comment on questions of policy.

In short, we express a number of concerns with the quality of the analysis presented in this supplementary analysis. We further extend our concern to the performance analysis in the PC's draft report on this topic where it covered investment performance using the same methodology.

Our concerns

Our concerns include:

- The size of the 'residuals' identified by the commission are too large to be of any practical use, they do not distinguish whether the cause of the residual is due to:
 - Tax, noting the PC has used APRA data to measure the effect of tax whereas published returns would incorporate accounting liabilities for tax not yet paid;
 - Indirect costs, which form a large portion of reported expenses that are netted off returns but do not pass through the fund's financial statements;
 - As such, the residual is not a useful measurement of 'alpha', in which case it is not a useful measurement for system performance at all.
- The inconsistency between the asset class analysis (above benchmark) and system level analysis (below benchmark):
 - We note the PC has attributed this to survivor and selection bias but hasn't proven that is the case;
 - We also note the Commission reported a high representation of '86 per cent of total assets' in 2017 its supplementary survey contradicting the 'selection' argument;
 - Further, should survivor bias be a cause of the discrepancy (only 66% of total assets in 2008 are represented) we note this would be evidence of an efficient system which consolidates underperforming funds.

- We question whether comments on funds underperforming an asset class benchmark for 'unlisted infrastructure' are of practical use given the difficulties of applying an appropriate index for this asset class.
- We have multiple concerns with the presentation of international comparisons:
 - Data is not for an equivalent time period, making it immediately an invalid comparison that should not have been published;
 - The PC notes that domestic equities comparisons are not fair as it is for different markets, yet still presents the analysis;
 - The PC has further failed to note that on a similar basis the international equities, cash and other comparisons may also be invalid;
 - For example, US fund investments in international equities will exclude US stocks, but Australian investments in international equities will include them;
 - Similar issues may arise in cash, infrastructure or private equity investments that may have a domestic bias;
 - We note CEM survey data relied upon for the comparison may not be representative of the entire international market as CEM provide services predominantly for large (mostly defined benefit) pension plans.
- We note, the reconciliation of industry and retail performance contain errors in the measured impact of differences:
 - Administration costs are listed as 0.5% for industry funds vs. 1.1% for retail funds, however the net difference reported by the PC is 0% rather than 0.6%;
 - We further note the reported 'residual' item is larger than the total difference the PC is seeking to explain.
- We question the validity of MySuper implementation timelines as a measure of 'Governance' and note the high correlation between industry and retail fund implementation timelines.
- We question the quality of much of the reported APRA data, particularly data on advice fee revenue, relied upon by the commission.

Our recommendations

We further reiterate our response to information requests from the PC's draft report:

Our main concern with the analysis is that it does not allow for the fact that the asset allocation is ultimately more important (for default funds) as it will largely drive the investment outcomes for members to a greater degree than individual security selection¹.

While we acknowledge that comparisons of the cost and performance of asset classes would be of interest, it is difficult to measure both of these. For example, we note the problems ASIC has had in setting suitable investment fee disclosure methods (RG 97). Similarly, comparing investment performance and reasons for differences in performance over long periods is inherently difficult. We commend the PC on attempting to do this, but the results are not valid due to current limitations in available data. This limits the scope for valid use of the results to reach conclusions and develop policy recommendations.

We suggest that the PC recommend that changes be made to the presentation and collection of data, so that such comparisons can be made in the future.

Yours sincerely

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¹ Rice Warner, Submission DR202 https://www.pc.gov.au/_data/assets/pdf_file/0006/230568/subdr202-superannuation-assessment.pdf