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Superannuation
Productivity Commission
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To whom it may concern:

Re: Superannuation: Assessing Competitiveness and Efficiency, Productivity Commission Issues Paper (July 2017)

We write in response to The Productivity Commission issues paper entitled, '*Superannuation: Assessing Competitiveness and Efficiency*' dated July 2017. The following Submission is co-authored by Dr Robert J. Bianchi (*Associate Professor of Finance, Griffith University*), Dr Michael E. Drew (*Professor of Finance, Griffith University*) and Dr Adam N. Walk (*Senior Research Fellow, Griffith University*).

The Productivity Commission's important work in assessing the efficiency and competitiveness of Australia's superannuation system is timely as we seek to improve retirement outcomes for members. We strongly support the Commission's life cycle (or life stage) approach to the assessment, viewing superannuation across the life stages, specifically, the accumulation, transition and retirement income phases.

Our submission focusses on two related, but separate themes within the scope of the Productivity Commission's report, specifically:

- *Costs, fees and net returns*; and
- *Improving retirement outcomes for members*.

We open with a discussion on costs, fees and net returns.

Costs, fees and net returns

Our submission considers the following three aspects of this important theme within the Productivity Commission's report, namely:

- *Asset classes, fund performance and investment strategies*;
- *Performance evaluation methodologies*; and
- *Analysis of datasets*.

<u>Asset classes, fund performance and investment strategies</u>

Our ongoing research agenda in the field of asset classes, fund performance and investment strategies has highlighted the complexities (and challenges) of seeking a 'one-size-fits-all' approach to evaluation. Our findings across various investment types (traditional asset classes; alternatives; unlisted assets; factor-based approaches; and, pooled vehicles) confirms that benchmark selection is critical in any evaluative approach, as is the time horizon of which manager skill (or otherwise) is evaluated. Our research also confirms the importance of whether 'success' (however defined) is considered through a frame of 'time-weighted' or 'money-weighted' returns. This is particularly important in the context of superannuation, as we consider returns an input (and only an input) to the member's fundedness in retirement. We would caution against an over-reliance on evaluative methods that place a priority on league tables (and other potentially myopic forms of measurement) over whether or not members can replace a significant proportion of their pre-retirement income (on a real basis) in the post-retirement phase.

Traditional Asset Classes

- Bonds (Bianchi, Drew, Roca and Whittaker, 2017);
- Equities (Aliouche, Bianchi and Drew, 2014; Bianchi and Drew, 2012; Bianchi, Drew and Nathie, 2015; Bianchi, Drew, Pappas and Tetteroo, 2013; Bianchi, Drew and Walk, 2016; Bianchi, Drew and Whittaker, 2016; Drew and Veeraraghavan, 2002);

Alternatives

- Hedge funds (Bianchi and Drew, 2010; Bianchi, Drew and Stanley, 2008; Bianchi, Drew, Veeraraghavan, 2010; Bianchi, Drew and Wijeratne, 2009a and 2009b),
- Commodities (Bianchi, Drew and Fan, 2015 & 2016);

Unlisted assets

- Infrastructure (Bianchi, Bornholt, Drew and Howard, 2014; Bianchi, Drew and Whittaker, 2017a and 2017b);
- Real estate (Drew, Walk and West, 2015);

Factor-based approaches

- Risk factors (Bianchi, Drew and Pappas, 2017);

Pooled vehicles

- Shariah compliant investments (Bianchi, Drew and Nathie, 2012);
- Superannuation funds (Clements, Dale and Drew, 2006; Drew and Noland, 2000; Drew and Stanford, 2001; Drew, Stanford and Veeraraghavan, 2002)

- Superannuation and retirement outcomes (Basu and Drew, 2009; Basu, Bryne and Drew, 2011; Bianchi, Drew, Evans and Walk, 2014; Bianchi, Drew and Walk, 2014; Bianchi, Drew, Walk and Wiafe, 2016; Drew, Stoltz, Walk and West, 2014; Drew, Walk and West, 2016; Drew and Walk, 2015 and 2016); and
- KiwiSaver retirement in New Zealand (MacDonald, Bianchi and Drew, 2012).

<u>Performance evaluation and methodologies</u>

An issue that warrants detailed consideration in any discussion regarding performance evaluation is the appropriateness (or otherwise) of the empirical technique used to assess risk-adjusted outcomes for members. For more than fifty years, scholars and practitioners have searched for the 'perfect' evaluation methodology. As is illustrated below, state-of-the-art techniques have moved from simple single-factor evaluation through to multi-factor approaches and complex statistical and regime-based methods more recently. We stress that even in 2017, there is continued debate as to what constitutes a 'good' evaluative methodology, what an appropriate time horizon is for statistical and economic significance and how, if at all, the evaluative technique is directly aligned to outcomes in superannuation. A synopsis of the various studies we have undertaken using these competing technique is provided below.

Single-factor

- Sharpe (1966) single-factor Capital Asset Pricing Model (CAPM) (Drew and Noland, 2000);
- Treynor (1966) model (Drew and Noland, 2000);
- Modigliani and Miller (1997) framework (Drew and Noland; 2000);

Multi-factor

- Fama and French (1992, 1993) three- factor model (Bianchi, Drew and Nathie, 2015; Bianchi, Drew and Whittaker, 2017a; Drew and Veeraraghavan, 2002).
- Bond three-factor model (Bianchi, Drew, Roca and Whittaker, 2017);
- Four-factor model (Drew and Stanford, 2001; Drew, 2003);
- Five-factor model (Bianchi, Drew and Fan, 2016; Bianchi, Bornholt, Drew and Howard, 2014);
- Six-factor model (Bianchi, Drew and Pappas, 2017);
- Eight-factor hedge fund model (see Bianchi, Drew and Stanley, 2008);

Statistical and regime-based techniques

- Time-varying cluster analysis (Bianchi, Drew, Veeraraghavan and Whelan, 2010); and
- Regime analysis (Bianchi, Drew and Walk, 2012).

<u>Analysis of datasets</u>

Finally, our published studies have analysed a plethora of datasets. Data quality remains an ongoing challenge (including the issue of survivorship bias, or history written by winners, see Drew and Stanford, 2001b) for studies in the field. Issues of pre- and post-fee data, taxation, consistency of unlisted asset valuation, provision of investment management fees (and potential performance fees) are some of the topical issues that will need to be agreed in any unified framework. The following papers provide a snapshot of the various databases used in our research agenda.

- Bloomberg (Bianchi, Drew and Fan, 2015 and 2016);
- Datastream (Bianchi, Drew and Fan, 2015 and 2016);
- Global Financial Data (Drew and Stanford, 2002);
- Lipper/TASS/Tremont (Bianchi, Drew and Stanley, 2008; Bianchi, Drew and Wijeratne, 2009; Bianchi and Wijeratne, 2009).
- Morningstar (Drew and Noland, 2000; Drew and Stanford, 2001a and 2001b)
- MSCI and Dow Jones Brookfield (Bianchi, Bornholt, Drew and Howard, 2014);
- Primark Australia (Drew and Veeraraghavan, 2002);
- UBS bond data and indices (Bianchi, Drew and Walk, 2012; Bianchi, Drew, Roca and Whittaker, 2017);
- van Eyk Limited (Clements, Dale and Drew, 2006);

Improving retirement outcomes for members

Our research findings over the past two decades has highlighted the challenges of benchmarking and evaluating the performance of both single- and multi-asset investment vehicles (particularly pooled funds such as superannuation). Good governance demands that best-practice evaluation is undertaken in a timely, robust and defensible way to ensure the interests of fund members are paramount. However, good governance also requires that performance evaluation is not simply to consider the inputs (manager returns, asset class returns, etc.), but rather, whether the investment strategy has been accretive to the stated objective of the superannuation fund. We posit that much of the energy and emphasis regarding the evaluation of superannuation fund performance has been on what we would describe as 'inputs' (albeit very important inputs, such as performance in league tables) and less on member outcomes (or fundedness).

Our work to date in the field of performance evaluation strongly supports that investment fees should be as low as practicable. Fees are a known expense today and the weight of global empirical evidence suggests that there is <u>no</u> positive, linear association between fee levels and post-fee risk-adjusted returns. While fees are one aspect to this debate, the other matter that requires further consideration is time horizon. We support initiatives (both formal and informal) that break the current culture of 'short-termism' and focus more on whether market participants are delivering outcomes for members over the long term (Drew, 2009).

Finally, framing in this debate is vital. Our research efforts to date have led us to conclude that success in superannuation is about ensuring members achieve a meaningful level of fundedness over their retirement years that mitigates the potential ravages of inflation, sequencing and longevity risk. In summary, we support policy approaches that prioritise the following issues for members:

(i) Greater emphasis on an **individual's superannuation account** (money-weighted returns) rather than the disproportionate allocation of energy on the fund or product (time-weighted returns);

(ii) The level of **fundedness** of an **individual**'s superannuation account (including greater emphasis on metrics such as their **retirement wealth ratio (RWR)**, annuity equivalent value (AEV) and inflation risk, see Bianchi, Drew, Evans and Walk, 2014);

(iii) Understanding time-varying **sequencing risk** faced by individuals over the life course (in short, what's safe and what's risky changes over your life, see Basu and Drew, 2009); and,

(iv) Ensuring an individual's super account is being managed to best-practice governance standards, see Drew and Walk, 2016.

Thank you for the opportunity to make the submission. We would be most happy to furnish any further details you may require.

RJB; MED, ANW
Brisbane
August 2017

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