SUBMISSION IN RESPONSE TO –

PRODUCTIVITY COMMISSION REPORT

SUPERANNUATION : ASSESSING EFFICIENCY AND COMPETITIVENESS

SUPPLEMENTARY PAPER – INVESTMENT PERFORMANCE

SUPPLEMENTARY ANALYSIS

OCTOBER 2018

1. This submission is submitted to the Productivity Commission in broad support of the submissions to the Commission prepared by the SMSF Association and others in defence of the SMSF sector from biased and ill-informed criticism.

2. In brief, there appears to be only one set of data which provides a coherent and consistent dataset for all super fund sectors over an extended period – this is the data contained in APRA's report titled –

   "STATISTICS : Annual Superannuation Bulletin – June 2017 (released 28 March 2018)"

   In my view this is the only dataset which can be used to make comparisons of relative performance between the major fund sectors. The data in Table 4a (especially the EXCEL the data downloadable from the APRA website) can be summarised as follows –

Data Item	SMSF Funds	Industry Funds	Retail Funds	Gov't Funds	ALL Funds
Net Assets at June 2003 ($B)	**101.5**	**69.1**	**174.3**	**108.5**	**485.5**
Net Assets at June 2017 ($B)	**696.7**	**543.1**	**588.7**	**560.5**	**2449.7**
Annual Growth Net Assets	**14.8%**	**15.9%**	**9.1%**	**12.4%**	**12.3%**
Annual Investment Yield	**8.8%**	**8.2%**	**6.2%**	**7.1%**	**7.5%**
Standard Deviation Inv Yield	**7.4%**	**8.7%**	**8.3%**	**8.3%**	**8.0%**
		SHARE OF COMBINED INCOME			
Net Contributions & Transfers	**54.7%**	**54.0%**	**59.3%**	**57.4%**	**55.1%**
Benefit Payments	**31.3%**	**17.6%**	**40.7%**	**44.5%**	**33.5%**
ALL Expenses excl Tax	**5.7%**	**6.1%**	**8.4%**	**3.2%**	**6.1%**
Other Misc Income & Expense	**1.0%**	**2.1%**	**2.1%**	**39.1%**	**8.7%**

   These items are described in more detail in Paragraph 4.

3. The observations and conclusions I would draw from these summaries are –

   (a) **the SMSF Funds sector is now larger than any other sector**;

   (b) **the SMSF Funds sector has delivered higher pre-tax investment returns than all of the other "professionally managed" sectors**;

   (c) **the SMSF Funds sector has delivered lower investment volatility than all of the other "professionally managed" sectors**;

   (d) **the SMSF Funds sector has lower expense rates than both of the "professionally managed" Industry and Retail sectors** – see below for further discussion on this item;

   (e) **Industry Funds have a Benefit outflow of less than 20% of Combined Income whereas all other sectors have a Benefit Outflow in excess of 30%** - this factor is probably a key driver of the very high net growth in this sector and would also reduce liquidity pressures which would normally be expected to boost investment yields.

   On any meaningful metric the SMSF sector has significantly outperformed both Industry and Retail funds - the Productivity Commission, the Labor Party, and the Professional Funds need to back off and let SMSF trustees and members get on with a great job of managing their own money!

4. Explanations and rationales for the specific metrics that I have chosen to examine –

   (a) All figures are derived from Table 4a in APRA's downloadable EXCEL database and relate to the period from June 2003 through to June 2017 – a period of fourteen years which encompasses the Global Financial Crisis.

   (b) It is assumed that APRA can be relied upon to supply data which is accurate and complete. There is, I think, an implicit assumption in the figures that all sectors value unrealised investment gains on a similar and consistent basis.

   (c) It is very relevant to note that the APRA figures are internally consistent by sector – in all cases the closing and opening asset values in each year reconcile to all reported fund inflows and outflows – this means that all items of income and outgo must appear somewhere in the figures so that any discrepancies in the allocation of income and expenses between different funds and different sectors will "come out in the wash".

   (d) The Annual Investment Yield assumes that all cash flows occur midway through each financial year – this is unlikely to introduce meaningful bias between the aggregates for each sector.

(e) The Annual Investment Yield is gross of tax and investment expenses – tax because the tax burden on different funds will reflect their particular circumstances and is largely unaffected by investment performance, and expenses because the distinction between various categories of expense can be arbitrary and is almost certainly inconsistent between the different sectors.

(f) The ALL Funds data includes data for Corporates, Small APRA Funds, and Single-Member ADFs which are not shown separately in the table in Paragraph 2.

(g) Combined Income is the sum of –

(i) Contribution Flows net of Contributions Tax;

(ii) Net Transfers IN;

(iii) Investment Income before Investment Expenses and Tax.

Net Contributions from Members plus Net Transfers represent between 54.0% and 59.3% of Combined Income across the different sectors so that the balancing item of Investment Income necessarily represents between 40.7% and 46.0% of Combined Income – at this macro-level there is not a great deal of divergence in the characteristics of the different sectors.

(h) It is obvious that the Industry sector has a very different experience in terms of Benefit Payments in comparison to all other sectors. On reflection this is no great surprise but any analyses of expenses or investment performance which do not recognise this fundamental difference in cash flows may be misleading and may give rise to views about the relative performance of the Industry sector which are not fully justified.

(i) **Most importantly - I prefer to measure expenses against revenues rather than assets – this is, after all, the most common way to do so.** From the Members' perspectives the gross income a Fund has is the Combined Income as defined in (g) above and expenses should normally be seen as an erosion of this amount. Calculating an expense rate against assets only makes sense if the overwhelming share of expenses are investment management expenses and if the overwhelming share of revenue is investment income – neither of these conditions hold for superannuation funds.

The other subtle nuance here is that the average duration of funds held will be much longer in an Industry Fund than is the case in the other funds sectors - because of the much lower Benefit Payments ratio in the Industry sector. If expenses are to be expressed as a percentage of assets each year then it must be recognised that <u>this expense rate will operate over a greater number of years</u>. The lower expense rates attributable to Industry Funds when measured against assets is largely illusory – this is a misleading measure in the context of sector comparisons of superannuation funds.

I suspect, but don't know for certain, that the expense rates for small SMSFs when measured against Combined Income rather than assets will be not so deleterious as is generally perceived.

(j) Other Miscellaneous Income less Expenses is not materially dis-similar between the SMSF, Industry and Retail funds. The very high figure for the Government funds is clearly an anomaly of some sort and probably worthy of further investigation. This final balancing item is likely to include fee income (effectively derived from other services charged to members), and franking credit refunds and offsets, amongst other possibilities. Please not this figure is 1% - 2% of Combined Income and not a percentage of assets.

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