mtaa super

26/10/18

Karen Chester
Deputy Chair
Productivity Commission
Locked Bag 2, Collins Street East
Melbourne VIC 8003, Australia

Dear Karen,

SUPERANNUATION FUND PERFORMANCE ASSESSMENT AND RISK-ADJUSTED RETURNS

On behalf of the Trustee of MTAA Super, I am writing to express our strong support for the assessment of superannuation fund performance to focus on risk-adjusted returns rather than a return-only approach.

Recent discussions in the superannuation industry, encouraged by undertakings such as the Productivity Commission's review into the competitiveness and efficiency of the Australian superannuation system, have centred around the concept of strong investment performance being a key measure of success for a superannuation fund. The concept of this strong performance has been two-fold – first, that a member investment choice option meets its investment return objectives that are published to members, and second, that the option is compared with its universe of peer funds with the view of determining performance relative to peers and the 'top performers' in each cohort.

In addition to investment returns, MTAA Super places considerable focus on the risks associated with each investment option. This is not just from the perspective of meeting the investment risk objectives set for each strategy and the Standard Risk Measure disclosed to members, but importantly the characteristics that influence the degree to which a portfolio is adequately compensated (in terms of returns) for taking on additional risk – that is, the 'risk-adjusted return'. MTAA Super actively communicates with its members ways in which risk can and should be considered alongside returns, over and above the mandated risk disclosures.

However, we consider that there is a disconnect between the industry messaging given in the marketplace, compared with the fund-level messaging to members.

Specifically, industry discussion and particularly that led by the media focuses solely on nominal returns, purporting that the 'best performing' funds are those that deliver the highest returns to members, without any consideration or distinction made for the amount of risk taken to achieve those results.

An Industry SuperFund

Trustee Motor Trades Association of Australia Superannuation Fund Pty. Limited ABN 14 008 650 628 AFSL 238718
Fund MTAA Superannuation Fund ABN 74 559 365 913 **T** (02) 6273 4333 **E** info@mtaasuper.com.au
Mail PO Box 6273, Kingston ACT 2604 **mtaasuper.com.au**

A driver of this is performance ranking surveys published by independent research providers, with publicly and freely available surveys containing no data on risk statistics nor risk-adjusted returns. While such surveys may also publish the traditional growth/defensive classification of assets and Growth/Balanced/Conservative (and other) classification of investment options, the wide ranges within each universe and the fund self-assessment that is inherently involved, undermine the usefulness of these traditional methods in their application for members. This becomes particularly apparent when comparing across superannuation funds.

Demonstrating the pertinence of different risk characteristics on investment option performance, MTAA Super's research suggests that of the top ten performing superannuation funds (on the basis of return) within the 'Balanced' universe published by research provider SuperRatings, four of those funds – 40% of the sample – fell outside of the top quartile in terms of their risk-adjusted return (measured by their Sharpe Ratio) for the 2017-18 financial year.

Examining trends in performance over time, it is no surprise that funds with higher disclosed allocations to listed equity dominate the list of top performing funds in rising market environments over short time frames (and vice versa in falling market environments). While examining performance over longer time periods and through the market cycle will smooth this to a degree, it nonetheless does not adequately capture the variability in risk characteristics offered across the industry. In addition, it does not reflect the risk associated with the differing time horizons of members, which span from very short term (for example, older members in the pension drawdown phase) to very long term (young members with a lifetime of investing ahead of them which could equate to 60+ years).

MTAA Super firmly believes that any industry assessment of superannuation fund performance, be it in the form of public forums and media, results published by independent research houses, or a 'best of show' list of default funds such as that proposed by the Productivity Commission, must focus on risk-adjusted returns as the key measure of peer-relative performance. An industry wide focus on risk adjusted returns would assist members to understand the level of risk superannuation funds are taking on their behalf to achieve the aspired objectives and highlight the inadequacies of considering nominal returns only.

MTAA Super understands that *Technical Supplement 4: Investment Performance Methodology and Analysis* is intended to provide further detail on the assessment of investment performance discussed in Chapter 2 of the Productivity Commission's *Superannuation: Assessing Efficiency and Competitiveness* draft report. Combined, the documents reference that 'risk' is considered when examining long-term net investment returns, noting there is a difference between 'risk' and 'volatility'. Technical Supplement 4 expands on the assessment and demonstrates how an average portfolio's return changes as the exposure to growth assets increases, but also demonstrates the significant associated rise in volatility. We note a key finding of the review is that *'there is significant variation in performance within and across segments of the system which is not fully explained by differences in asset allocation'* (Draft Finding 2.1).

MTAA Super considers that there is ambiguity as to how the risk analysis contained in these two documents translates through to the draft recommendations put forward by the Productivity Commission, particularly with regards to the 'best of show' shortlist of products to address poor outcomes for some members, and improving member disclosure. Specifically, this is because the descriptions of the recommendations refer purely to terms such as 'better net returns' and 'high performing products' without any documented consideration of elements of risk. We note the draft report states that *'the key focus of the selection process should be on a fund's likelihood of producing high net returns of members'* (refer to section 12.2, page 435). Should a 'best in show' shortlist be pursued, we consider it critical that an element of risk is a well-documented factor in the set of criteria that is used to judge the best outcomes for members, to be given at least equal priority to returns. This goes beyond simply defining the methodology used to determine the 'likelihood' of a high return, as it should recognise the relationship between return and risk through the concept of a risk-adjusted return. We welcome the opportunity for the Productivity Commission to make these points very clear in its final report and recommendations.

Yours sincerely

Leeanne Turner
Chief Executive Officer