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INVESTMENT ANALYSIS & STRATEGY

Response to Request for Feedback on:

Legislating the Objective of Superannuation, Consultation Paper,

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Provided by :

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Purpose

This document provides our response on the recent Request for Feedback on the Consultation Paper published on 20th February 2023, entitled "*Legislating the Objective of Superannuation*".

In summary, although we agree with the intended sentiment of the objective (*preserving savings to deliver income for a dignified retirement, in an equitable and sustainable way*); we are concerned that the proposed wording tries to oversimplify this, thereby substantially reducing its effectiveness.

This concern is based on three issues:

1. Lack of distinction between preserving the real and the nominal value of savings; resulting in a potential loss of purchasing power caused by inflation.
2. Potential erosion of the real value of net savings through inappropriate management and administration fees.
3. Potential for intertemporal inequity due to failure to protect against biases due to different investment horizons, since different superannuation contributors may have very different times to reach preservation age.

Credentials

Dr. Brindha Gunasingham, CFA is the Founder and Managing Director of FitzBiz Investment Analysis & Strategy; a consulting business that has been providing strategic consulting services and investment insights, using econometric and quantitative techniques, to investment, financial services, and education organisations across the world for 20 years.

Brindha is an extremely experienced and well respected global finance and investment consultant, economist, econometrician, researcher and strategist. She has been dedicated to the investment and financial services industry for over 30 years with experience working in Australia, as well as the UK, US, and other parts of Asia.

Holding previous senior roles, which include Global Head of Research for AMP Capital, and Australasian Head of Research for PricewaterhouseCoopers Financial Advisory Services, as well as conducting numerous relevant consulting projects related to superannuation, investment management, economic issues and market structure over the past 20 years, Brindha is well versed in the practices and skills required for rigorous economic research, analysis, modelling and risk assessment. She was also appointed as an inaugural advisory board member for the CFA Institute Asia Pacific Research Exchange. She has a strong publication history as the co-author of multiple post-grad level university textbooks in investment and finance, and as the author of numerous other investment, econometric, economic and research reports as well as articles for CFA Institute and other industry publications.

Brindha is well respected across the global investment industry with very strong links to the Chartered Financial Analyst (CFA) network, and is sought after to provide insight on strategic and innovative issues. For example, she has been invited to present at the International FundForum in Monte Carlo, Global CFA Institute Investment Conference in Hong Kong and at the Performance Attribution and Risk Conference in Sydney. She also has expertise in investment and adviser regulation and education. As a Past President of the CFA Society of Sydney, she has also

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been involved in various programs focused on improving and maintaining professional, educational and ethical standards across the domestic and global investment industry.

As a former Full Professor of Economics and Dean at a Forbes Global Top 20 business school, she has pertinent economic academic experience backed by impressive academic credentials. These include a PhD in econometrics and finance as well as three further degrees in economics from top UK and Australian universities, as well as being a Chartered Financial Analyst (CFA) charterholder. Her doctoral thesis, entitled "*Time Incongruency: Impacts on Optimal Portfolio Investment Decision Making*"; combined theoretical modelling and empirical work, focusing on the management of non-systematic and systematic risk, in conjunction with investment horizon mismatches. This work is particularly pertinent to superannuation investments.

Concerns with the Proposed Objective of Superannuation

As previously summarised, we have three major areas of concern related to the proposed wording of the objective:

1. Loss of Purchasing Power Caused by Failure to Adjust for Inflation

Most superannuation members contribute a large part of their superannuation assets via their employer contributions through the Superannuation Guarantee. This is compulsory, and although it is referred to as "employer contributions" it is in effect part of each worker's compensation for the provision of their labour (or part of their total income). However, workers are not given the choice of how to allocate the consumption of this income, but are forced to divert this to their superannuation accounts; delaying consumption of this income until they reach preservation age (or later).

Given this background, it is important that workers should not be disadvantaged with respect to the purchasing power of this delayed consumption. Inflation during the term of the investment will potentially reduce purchasing power. This issue has more potential to negatively impact workers with shorter timeframes until they reach preservation age, since younger workers may have time to catch up on value over time. This contradicts the proposed objective of *equitable and sustainable outcomes* for all members of the same superannuation fund.

Thus, we agree that it is important to preserve the value of these "savings", as suggested in the proposed Objective of Superannuation. However, this wording fails to emphasise the need to preserve the real, rather than nominal value of savings.

We think it is important to highlight this need and to emphasise requirements to protect against the erosion of the real value of superannuation assets due to inflation. One way to do this would be to include an objective to ensure that superannuation asset values are, at the very minimum, index-linked to the inflation rates applicable over the life of the investment.

With this issue in mind, we think the proposed objective should be amended to:

"*The objective of superannuation is to preserve* ***the real value of*** *savings to deliver income….*"

2. Potential Loss of Net Value Caused by Inappropriate Management Fees

As detailed in the previous concern, we think it is important to protect against the potential erosion of purchasing power of the delayed consumption of the income that is initially diverted to superannuation investments. Thus, it is

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important to preserve the real value of these savings. However, we have experienced instances where regular management and administrative fees charged by superannuation managers have far exceeded the growth in value of the superannuation assets over a number of periods. In these instances, the net value of these superannuation savings have been eroded.

We acknowledge that different superannuation investment managers may have different cost bases and revenue models or fees structures (for example performance fees). Indeed, this is part of what individual members ought to assess when choosing their superannuation managers. However, in reality, many workers may be ill-equipped to make such an assessment, or to foresee the erosion of their superannuation savings due to such fees.

Thus, we believe it is important to try to avoid these situations by ensuring the Objective of Superannuation focuses on preserving the net value of savings.

With this issue in mind, we think the proposed objective should be amended to:

"*The objective of superannuation is to preserve* ***the real value of*** *savings****, net of management and administrative fees,*** *to deliver income….*"

3. Potential for Intertemporal Inequity Due to Failure to Protect against Biases Due to Different Investment Horizons

Our third concern focuses on the desired objectives around equitable and sustainable outcomes for people in similar circumstances.

Our research has proven that different investment horizons change the risk and return profile of the same underlying portfolio. This is due to biases introduced into standard investment models, purely as a result of the investment horizon, or time. Thus, younger workers, with a much longer time to reaching preservation age (or a substantially longer investment horizon) than workers that are close to accessing their retirement savings; have the potential to be substantially disadvantaged if their superannuation assets are allocated using the same portfolio composition. This would mean that by the time they reach retirement, they may not have a similar income to fund a "dignified retirement" that the members who retired earlier had.

In summary, there is potential for intertemporal inequity due to failure to protect against biases due to different investment horizons, since different superannuation contributors (or cohorts) may have very different times to reach preservation age.

We think it is important that the Objective of Superannuation recognises and protects against this issue. Although the current proposed wording may allude to this with the term "in an equitable and sustainable way", we think this is vague and does not recognise that different cohorts may need to be managed differently over the life of the investments, in order to achieve an equitable end outcome.

Conclusion

In the interests of brevity, we have summarised our concerns in this document. However, we would be happy to provide further details or discussions, if they are of interest.

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