UNSW SYDNEY

23 April 2024

Superannuation Efficiency and Performance Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Director

Re: Annual Superannuation Performance Test - design options

I apologise for the lateness of this personal submission but I am making it to counter the somewhat submission made by Vanguard of which I became aware yesterday. While I have the greatest respect for their business, the article appears to make them shamelessly self-serving. Passive investment and low costs have their place in the market, but the investment markets will not efficiently direct funds into their most productive use if there are not enough active managers in the market.

I have a long-standing interest in investment performance analysis as a member of investment committees, researcher and as a consultant attempting to persuade trustees to purchase attribution analysis software.

In a nutshell, the test fails to understand the randomness of investment markets and deflects supervision away from the causes of poor investment performance that should be addressed to protect superannuation members.

For a sound academic approach to understanding performance measurement and randomness, I refer you to Chapters 21 and 22 of Larry Harris's book *Trading and exchanges: Market microstructure for practitioners*. Chapter 21 deals with the evaluation of trading processes, which is undervalued by Superannuation trustees. Chapter 22 includes the following quote, which encapsulates the best current understanding and makes nonsense of the performance test.

> *Financial researchers have observed that essentially no correlation exists between the best performing funds in one year and the best performing funds in the next year. Good past performers are about equally likely to be good future performance as poor past performance. Good past performance simply does not regularly predict good future performance.*
>
> *(The very worst performing funds however tend to remain at the bottom from year to year. These funds typically lose because they trade too much and because they have high management fees. As long as these conditions do not change, they stay at the bottom.)*
>
> *These results are very robust. They are true for equity funds bond, funds and commodity funds. The results are uniform across yours and cross countries. The result are similar*

when performance is measured by quarter by month. The result do not depend on the criteria for identifying the best funds, the empirical results strongly suggest that statistical methods cannot reliably predict future performance from past returns.

There is also evidence that conflicts of interest can contribute to poor investment choices (see the last two references below.) Regulatory supervision should therefore be focussed in identifying overtrading, overcharging and conflicts of interest. These would be identified by appropriate detailed attribution analysis, which the Productivity Commission declared was “critical to funds understanding and improving their performance.” APRA’s ongoing failure to include them in SPS515 or SPS530 is deeply unfortunate.

The principles in the Discussion Paper are inappropriate because comparison against any benchmark is not helpful to predict future performance. The test should be abandoned and replaced by a requirement to perform detailed attribution analysis, which can be interrogated by APRA.

Yours sincerely,

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Some useful references

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