19 April 2024

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

By Email only: YFYS@treasury.gov.au

Dear Sir/Madam

Annual Superannuation Performance Test – design options
Response to Consultation Paper

Fiducian Group Limited (ABN 41 602 423 610, ASX code: FID) (**Fiducian**) is a national company with offices in capital cities and regional centres around Australia. Our five operating divisions provide the following services:

- Financial planning
- Investment funds management
- Superannuation
- Investment platform administration
- Information technology solutions

We take a keen interest in matters that impact the services we provide to our clients and we now provide our response to the consultation paper in relation to the Annual Superannuation Performance Test – design options that was released for comment on 8 March 2024.

Rather than responding to the individual questions within the Consultation Paper, we will address the broad topics that are being considered within the Consultation Paper.

Options For Reform

We have noted the guiding principles and do not disagree with their application to the superannuation industry in general.

Design Option

We note the Consultation Paper seeks responses on a more sophisticated and objective performance test. However, our view is that any performance test is more appropriate for MySuper products where members have little or no interest in their investments and expect the Trustee of the MySuper product to make product/investment choices in an appropriate way. The current Performance Test is a blunt instrument as it looks solely at the performance of a product and does not take into account the broader implications that affect investment options and the members investing in that product. The ability for a member to choose their investments, with guidance from their financial advisers, means that the member is actively considering their risks when investing and as such, the meaningfulness of the Performance Test is limited as the expectations of any single active member cannot be met by the current structure of the Performance Tests. That is why we suggest that the Performance Tests be limited to MySuper products or those with limited member engagement.

We expand on this view as follows.

1. The use of similar Performance Tests for MySuper and Choice Funds is not comparing like for like.

2. The Choice Funds industry has been developed to offer retail funds through wrap style platforms which offer a wide range of investment choices. These Choice Funds were never meant to compete with MySuper products.

3. Choice Fund members are usually directed through financial advisers who choose the appropriate investment mix, which could be a range of managed investment schemes and listed securities. These are tailored to suit an individual member's risk profile that is consistent with a Statement of Advice. Members may opt for individual style funds such as Global Smaller Companies, Technology, exposure to individual countries or ETFs which may not be measured against an appropriate benchmark, but a benchmark set by Treasury unrelated to the investment product. Performance may not necessarily be a prime objective and lower risk, with greater diversification and choice of different underlying fund managers, may be preferred.

4. Members may require constant monitoring and advising for their family and lifestyle goals. This requires transparency of reporting, security holding and frequent alteration as and when a member's perception of economic circumstances and financial goals change. This is possible through superannuation wrap platforms that deal with individuals on a case by case basis.

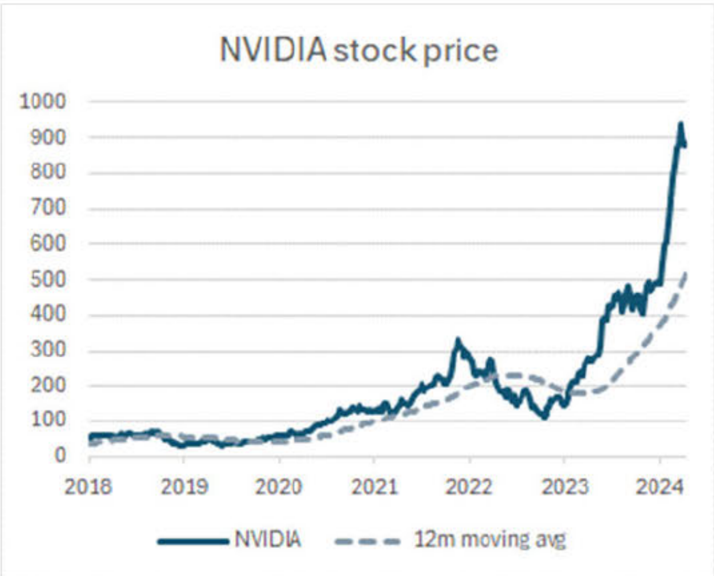
5. The membership base of MySuper products generally comprise persons who are directed by their industry body or union to join these funds, e.g. REST, CBUS, UniSuper, Mine Super etc. Their members are generally not advised and are invested in pooled funds that may or may not be ideal because individuals with differing personal circumstances are not considered in a MySuper product rather an "average" member is considered. Because of this, these funds should not be compared with Choice Funds, which enable individuals to make personal investment decisions and are not directed by an industry or professional body.

6. The performance of retail funds should be compared with the performance of peer group funds reported on recognised surveys, produced by independent ratings houses such as Morningstar, Zenith and Lonsec. Industry funds are not reported on these surveys.

7. The pass mark parameter for Performance Tests should be a performance above a minimum standard (at most the average) of all retail funds within a category on a recognised survey over a 10-year cycle. For example, Capital Stable, Balanced and Growth style Funds are compared, with anywhere from 60 to 100 funds being reported on these surveys per category and this is a wide comparison. Many of the underlying assets could by ETFs or other asset sectors that are not represented within the performance testing benchmarks noted in the consultation paper and have not been considered.

8. The retail choice sector offers a range of fund managers who in the main are active managers. Active management by itself requires a manager to take certain risks to achieve returns. As a result, these funds may perform below an index return over any given time period, especially during times of irrational exuberance from investors for a particular set of securities. The chart below shows very clearly the performance of the S&P 500 index in the US with and without the top performing 7 stocks (the 'magnificent seven') over a time period. It is evident that 483 shares together delivered lacklustre returns.

However, active managers may consider these shares to be overvalued and representative of a mania, which could eventually lead to tears as history has proven time and time again. See the graph of the top-performing technology stock, NVIDIA below and its future earnings guidance, with its price having risen continuously and having distorted the S&P 500 Index.



Source: IRESS

Fiducian Group Limited
ABN 41 602 423 610
Head Office: Level 4, 1 York Street, Sydney NSW 2000 | GPO Box 4175, Sydney 2001
Tel: +61 2 8298 4600 | Fax: +61 2 8298 4611

9. Under the above scenario and massive dispersion from the norm, an active manager may be proven to have been a bad manager and under the performance tests would receive a fail. However, this could all change if there is a reversion to the mean for technology stocks, but by then it may be too late for the fund manager, because it may have had to shut its doors due to 'underperformance' over a given time period.

Broader considerations of Reform

When considering reforms to the nature and construct of the Performance Test, we detail a number of matters below that we believe Treasury needs to consider in their entirety as these impact on individual goals and aspirations, and not just assess measurement against certain indices selected by Treasury.

1. The Performance Test seems to have missed the most common of all investment maxims: '*Past Performance Is No Guarantee Of Future Performance*'. There are reports of a number of funds that have been shut down, only to have rebounded strongly after the shutdown to the detriment of members who were not able to benefit from the rebound. Funds may outperform because they hold securities and assets that may have become overvalued, while failed funds may not have had the same exposure to these assets. By moving members to these higher performing funds, Treasury risks pushing members into assets that are overvalued, which at some point in time must then decline to the detriment of members.

2. Treasury expects that fund managers must not hug a benchmark (the index), which in itself opens them up to potential failure if they take the 'risks' necessary to achieve above-benchmark returns over time. If the expectation is for investment managers to compare results with an index, then why not mandate that all investments must be in an index. Treasury should mandate the fees payable and everyone should manage in accordance with these guidelines. What then does this do for public expectation, because as all fees are now the lowest or the highest and all performance is the best or the worst at the same time. Therefore, such an outcome would remove choice and there would be a lack of motivation by members to earn more through their own choices.

3. Many of the current performance benchmarks cannot be appropriately applied to Choice Funds as they do not align with the investment objectives of the Choice Fund or the underlying assets which are not represented in the large indices, which leads to unreasonable results when the Performance Test is applied. It appears Treasury is guiding fund managers, financial advisers and individuals to direct their investments only into asset sectors and securities that are represented in the indices in the performance benchmarks, which are represented in large cap indices. This is at odds with a person's ability the make their own investment choices in alternative and growth investments. For example, a Choice diversified fund is being compared with specific sector indices which may have little relevance to the diversified investments in the fund. Such a product is then doomed to fail in an environment where there are external shocks from wars and geopolitical unrest. Even if members have personally chosen these investments that have been proven to deliver superior returns over the long term, they will be pressured to exit such products if, within a certain unsteady economic period, they may not have bettered certain indices that don't relate to them. This is a serious flaw in the testing process, because products are tested against non-relevant indices (such as small caps ranked against large cap indices under the Performance Test).

4. More specifically, the assumed annual fee in the performance testing benchmarks are unrealistic and do not reflect the costs within the retail financial services sector. For example, the assumed annual fee rate for Australian Equities is 0.05% and International Equities is 0.09%. These may be applicable for mega funds that in-source the entirety of their investment management where they select their own securities, own investments (for example Sydney Airports) or have their own index funds managed by their own small teams of employees. Treasury should look at the fee scales in the retail market and determine appropriate scales when setting performance testing benchmarks, which we advise should not apply. Anecdotally, costs for an index fund cannot be obtained for less than 0.25%, which is then blended with active manager funds with fees of 0.35% to 0.6%, and then all blended together by a separate manager to give members a diversified investment option that members can choose to be invested in. Treasury should devote time to oversee and better understand the average fees offered within retail funds so that a more appropriate fee benchmark is established, if that is the chosen course. The fee structures

represented by Treasury in the consultation paper sends an unrealistic message to the retail industry that the cheapest is always the best, which it is not always the case.

5. Retail funds have marketing, distribution, promotion and management costs that are to be derived from relatively small levels of funds under management and no guarantee of inflows. These are genuine costs and the Government needs to decide whether it wants to stifle entrepreneurship and free thinking and direct all investments into large industry funds whose costs and charges are not fully understood by the marketplace and whose real performance is often marked by a high allocation to unlisted and illiquid investment that are only valued intermittently with little transparency about the valuation process such as it is. Moreover, where an affiliated subsidiary fund is offered on external wrap super platform, it is not required by APRA to get tested for performance. However, if they are within a super fund offered by an affiliate, they do need to undergo a performance test. This is a contradiction.

6. In the current form, the Performance Tests are proposed to be carried out over a 10 year period. This implies that a fund can continue to underperform its peers for up to 9 years, deliver poor results to investors over this period and then sell out or shut down without the product being tested. In comparison, retail investments provide their investment returns on a monthly basis and are compared against other investment options within their peer group. This monthly performance reporting provides investors constant feedback of their investment against their peers and allows a member to elect to make changes to their portfolio in a proactive manner.

7. In the retail space, investors are generally not concerned about performance against a benchmark, but the ultimate returns achieved from that investment and returns against others in their relative peer group which they can choose from. There could be funds that remain true to label and deliver expected returns but could have failed against the testing benchmarks provided due to unforeseen fractures in normal economic conditions. This is another reason why we recommend that Performance Tests should not apply to the retail sector.

8. Treasury also seems to have missed the matter of liability where an adviser has selected a particular fund for specific reasons but is then required to move a client to another fund because of the Performance Test. Such a move will trigger reinvestment risks and also the risk of moving clients to a fund that may have performed better over the past Performance Test period by matching an index benchmark, but could then underperform for a variety of reasons, such as holding overvalued securities. If the new fund underperforms the old fund then who will be liable to pay compensation in the event of client claims against an adviser? Will it be the failed fund, the underlying fund manager, or will it be the Trustee or will Treasury set up a fund of last resort for such purposes?

Summary of Recommendations to Treasury

We provide the following recommendations:

A. Where products are recommended by financial advisers after considering their clients' circumstances and risk profiles, such products should not have to be performance tested. Advisers have a best-interest duty of care for the financial interest of their clients, whereas Trustees are only focused on the account held by their clients within their fund and is far removed from the life circumstances of its clients. Under the unintended outcomes of the Performance Test, Trustees could enforce investment switching which could eventually prove detrimental in terms of a client's best interests.

B. Performance Test should only be for MySuper products or where this is little involvement with an adviser or member. If in the alternative, a performance test is still to be calculated, funds should be compared in peer groups by recognised independent ratings houses. However, if the current performance test assessment is to be retained, then Treasury must consider the manner in which the performance testing benchmarks are developed to ensure that outcomes sought from the testing are reasonable and provide an appropriate comparison of the investment objectives of the tested Choice Fund.

Fiducian Group Limited
ABN 41 602 423 610
Head Office: Level 4, 1 York Street, Sydney NSW 2000 | GPO Box 4175, Sydney 2001
Tel: +61 2 8298 4600 | Fax: +61 2 8298 4611

C. Funds that can be offered on multiple wrap platforms should all be given the same treatment. If they can be offered on any wrap platform without a performance test, then it should be the same for them in a platform that may have an affiliated trustee.

D. Under current legislation, a product that is offered in an Account Based Pension phase to members is not performance tested because it is expected that members alter their portfolio to ensure longevity in their savings. If similar investment fund structures are implemented within the Accumulation phase, where there is monitoring by members and they are advised, then there's no need for these products to be performance tested either. It is thus illogical for the same product to be performance tested in the superannuation phase of the same wrap fund just because it is offered by an affiliated investment manager.

E. The performance of each diversified or sector fund on a wrap style "choice" superannuation platform should be reported monthly on surveys of leading ratings houses such as Morningstar, Zenith or Lonsec etc. It should be up to a member or their adviser to assess the performance of their investments and not the Trustee.

We thank you for giving us the opportunity to respond.

Finally, please remember the well-known adage that 'Past Performance is No Guarantee of Future Performance'. While uninformed members of industry and My Super funds may not be actively involved in assessing the performance of their Superannuation assets, the same cannot be said for retail investors in wrap platforms who have specifically chosen investments with the help of their financial advisers, often for the multi-manager diversification benefits of products offered within the Choice Fund. We hope this can persuade you to reconsider some key aspects of your proposals.

Please call me on [redacted] or email me at [redacted] should you wish to discuss any of the matters raised in our submission above.

Yours faithfully,

[redacted]

Indy Singh
Executive Chairman