Royal Commission Submission
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Stockspot is Australia's leading online investment adviser and fund manager. Stockspot was created with the aim to help democratise investment advice and funds management via greater transparency and alignment between adviser and client.

Stockspot has been among the many voices calling for a Royal Commission into Banking Misconduct and we were pleased to see it commence in 2018.

Stockspot's ***Fat Cat Funds Report*** looks at the performance of Australia's largest superannuation funds. This is the sixth year Stockspot has run the report and in the 2018 research we compared the largest 500 super fund options to assess how they have performed after fees since 2013.

The purpose of this report is to help Australians understand the factors that matter most when picking a super fund for long-term performance.

The Report has rated funds based how they have performed after fees over 5 years compared to funds of similar risk. Based on this we have singled out two groups of funds which we believe warrant extra attention:

Fit Cat Funds: These are funds in the top 10 of their category over 5 years.

Fat Cat Funds: These are funds in the bottom 10 of their category over 5 years.

By shining a light on both the top and bottom performers our aim is to effect some change: by funds taking actions to improve their performance, getting consumers to take notice and consider their options, or by Government intervening to improve fairness and transparency.

Below we share with the Royal Commission high level findings from our 2018 Fat Cat Funds report.

Fat Cat Fund Findings:

For the sixth year in a row [redacted] have topped our list with the most Fat Cat Funds. For six years we have been waiting for [redacted] to respond by reducing the fees in these funds or transitioning clients to better performing options. Instead we have observed that many of their poor performing funds have increased (not shrunk) in size. This speaks to the member inertia, category complexity, absence of healthy competition,and conflicts in distribution arrangements that enable bad actors to flourish within the Australian superannuation system.

High fees:
Every year we also find that Fat Cat Funds generally have higher fees than Fit Cat Funds. There is a clear correlation between high fees and long-term underperformance.

Poor fund performances comes predominantly from active management and higher administration and operating expenses than necessary.

The impact of fees becomes more apparent with each passing year as funds find it more and more difficult to generate sufficient returns to make up for the drag of higher costs.
We find that many Millennials paying 1.5% per year or more in super fund fees are likely to be giving up over $250,000 before retirement due to unnecessarily high fees.

Despite the introduction of the Future of Financial Advice (FoFA) legislation in 2013 which aim was to help consumers, many Australians' life savings remain trapped in funds that consistently underperform their peers and benchmarks due to higher than necessary fees. The MySuper reforms do not appear to have had a material impact on reducing fees.

Active fund approach diminishes returns
We looked at a comparison of actual superannuation outcomes with an index fund of equivalent risk after costs and taxes.

Over 5 years we found just 4% of Balanced funds were able to beat an index fund with similar risk after costs and taxes. Across all risk categories fewer than 15% of funds were able to outperform the indexed option. This mirrors findings in other markets including the UK where actively managed mixed-asset funds have been unable to match low-cost indexed options. It appears that default fund members would benefit greatly if all money simply went into a low cost index fund.

The opposing interests of principals and those institutions who act on their behalf (including the consultants they employ) appears at least in part to blame for this not happening.

An important agency issue is that consultants to superannuation funds want to earn recurring fees. They have a vested interest in appearing to be active and in making adjustments to their recommendations from year to year. However almost invariably, assuming funds have the right strategic asset allocation in place, the best advice for trustees is to do nothing and to leave their portfolio as is.

The authors Herman Brodie and Klaus Harnack recently examined the research on pension plans globally and consultants which they published in *The Trust Mandate*. They found:

- Consultant recommendations add no value; the funds that are hired underperform the funds they replace over subsequent periods.
- Consultant recommendations are positively correlated with higher fees. Consultants have an interest in recommending complex (expensive) products because they require greater (costlier) due diligence and monitoring by the consultant.

Super fund trustees need to acknowledge the empirical evidence that consultants cannot identify winning fund managers in advance. Paying them in the hope that they will do so on balance reduces the net return for super fund members.

Our recommendations
Given that superannuation is the single most important savings pot most Australians will have in their lives Government urgently needs to address and reform policy on super and intervene to improve fairness and transparency for Australians.

Trustees, directors and advisers have a fiduciary and other duties to protect members interests, to avoid conflicts and to meet standards. Regulation doesn't adequately address the many principal-agency problems and conflicts of interest that currently exist. Competition and choice do not seem to work either, partly because of a lack of effective transparency over costs and their impact, as well as inertia and member apathy.

We believe Government should intervene to improve fairness in three ways:

1. *Create a low-cost alternative default fund or implement a public tender process for the right to manage default super funds via a fee-based auction.*

Data shows over all time periods that low-cost and higher net returns have a strong positive correlation, particularly over longer periods of time.

This year the Productivity Commission has recommended a 'best in show' shortlist to improve super outcomes. We see some problems with this recommendation. The selection criteria for the 'best in show' shortlist would be likely to preference funds who have been recent top performers due to fortunate asset tilts. This can often be mean reverting so the super funds at the top of the list over one rolling 5 year period are not likely to stay there over longer periods unless they are also low cost funds.

2. *Require all superannuation funds to provide their fee and performance data in a standardised format to a government-backed fund comparison website so that consumers can easily compare their options.*

   Currently it's almost impossible to see how different products are really performing because the data isn't available in a standardised format. An easy to use fund comparison website would help consumers and advisers make a more informed decision when selecting a fund.

3. *Require all superannuation funds to publish their investment allocations by fund manager, the fees paid to each manager, and their net of fee performance.*

   Currently disclosure of fund management costs is limited to regulated entities and most funds management is outsourced. It is telling that only 5 of 208 funds were prepared to provide asset level returns to the Productivity Commission. By improving transparency on performance attribution, funds will be held more directly accountable for performance results to their members and we believe will focus more on costs.

Final word
Too many Australians are unaware of the devastating impact high fees have on their long-term retirement savings.

It is clear from our research that the scale of the conflicts of interest are so deeply embedded in Australia's financial institutions that the impact is harming people. This has led to a situation that impacts many Australians, who will not be able to afford a comfortable retirement due to the impact of unnecessary superannuation fees over their lifetime.

The Royal Commission into Banking Conduct has brought to the surface some of the reasons consumers end up in poor performing funds. Many relate to agency issues arising when stakeholders including financial advisers, trustees, executive teams, fund managers and consultants have incentives that are not aligned with the end super fund members.

We hope that the recommendations that come from the Royal Commission lead to changes to the superannuation system which results in fewer conflicts and better outcomes for Australians.