CareSuper

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Dear Sir or Madam

CareSuper submission – APRA consultation draft Reporting Standard (SRS) 550.0 Asset Allocation

Thank-you for the opportunity to provide a submission in relation to Topic Paper 5 which provides detail on draft "Reporting Standard (SRS) 550.0 Asset Allocation" (SRS 550.0).

CareSuper supports APRA's aim to enhance the assessment of investment risks and exposures, and the objective of improving comparability and consistency. CareSuper's objective is to support these goals though the feedback provided as part of this submission.

Overall Comments

With respect to the proposed SRS 550.0, CareSuper considers that there are a number of overall concerns that should be raised which may have unintended consequences for members and funds as well as overall concerns regarding the practical application of the new proposed reporting requirements.

While these concerns have been outlined in more detail in our responses to the Consultation Questions, they have been summarised as follows:

GAMING AND MOTIVATION
There is scope for Funds to 'game' asset categorisation as well as the potential for Funds to alter Strategic Asset Allocations ("SAAs") with the aim of improving heatmap outcomes. Accordingly, there is potential for investment decisions to be made for reasons of regulatory assessment, rather than investment merit. The long-term implications for members will be a reduction in their retirement benefits.

ASSET CATEGORISATION
CareSuper has some concerns regarding the proposed asset categories particularly in relation to their clarity, purpose and application. These concerns are outlined below in our detailed response. In order to achieve consistency in reporting outcomes, we would welcome the opportunity to liaise with APRA regarding achieving greater clarity in both the definition and the intent of the changes.

CONFIDENTIALITY
CareSuper is concerned that the public disclosure of detailed asset allocation and investment exposure information will compromise the interests of members, Funds and other industry participants. Disclosure of this information would reveal proprietary information, as well as positioning in a prejudicial manner and expose sensitive information that should otherwise not be known by market participants.

FAIRNESS ACROSS BUSINESS MODELS
It is noted that one of APRA's objectives is to improve comparability and consistency. CareSuper is concerned that this consistency will not be achieved due to the potential for advantage or disadvantage depending on a fund's particular business model:

- retail versus industry,
- outsourced models versus vertically integrated or internally delivered.

CareSuper believes that no particular business model should be favoured as this has the potential to motivate business decisions and also reduce the reliability and comparability of the data for both members and APRA.

Detailed Feedback

Our detailed feedback is provided in line with the relevant Consultation questions: Asset Allocation detailed in Question 5 of APRA's Topic paper:

Consultation Question 1: What difficulties, if any, may be caused through the implementation of draft SRS 550.0 and how could they be addressed or mitigated?

STRATEGIC ASSET ALLOCATION VERSUS ACTUAL ASSET ALLOCATION AND ASSESSMENT

As outlined in our overall comments regarding the scope for Funds to alter SAAs with the aim of improving heatmap outcomes, it could be possible to reduce the return of the overall SAA in a way that favours performance assessment.

APRA may be able to identify this by comparing Actual Asset Allocation ('AAA') to SAA – noting Funds that are constantly or materially holding Actual Asset Allocations in (for example) shares and 'riskier' investments at a level greater than the SAA. Funds must be able to be overweight risk assets at various stages, but a permanent overweight could indicate 'gaming'. It may be difficult for APRA to identify this in practice and Funds may have cogent arguments against such an assertion that an overweight allocation is not for legitimate investment reasons but is instead to 'game' the reporting system.

While we do not have a solution to this issue, we would request that APRA be cognizant in its assessment of the data of the potential for funds to alter SAA's with the aim of improving heatmap outcomes.

GROWTH / DEFENSIVE AND RISK

CareSuper considers it is difficult to provide detailed feedback on Asset Allocation without understanding how APRA intends to treat various categories. CareSuper would welcome additional clarity from APRA regarding the treatment of various categories as one impacts the other. Furthermore, we note that growth/ defensive is one partial measure of risk.

Proposed Change:

CareSuper believes that APRA should consider whether the benefits of diversification are being adequately considered in the assessment of asset allocation. It is also proposed that other risk measures, such as standard deviation, should also be considered. A measure such as standard deviation also has disadvantages but may be a useful addition to the analysis and to be considered in combination with other factors.

Consultation question 2 - Do the proposed asset class subsectors provide the ability for investments to be effectively differentiated with respect to their risk/return profile variations, and if not, what changes would address this?

CareSuper considers that there are issues potentially impacting the effectiveness of the proposed subsectors.

CareSuper expects that some funds will be unable to provide characteristic 1, 2, 3 data on a look through basis and/or encounter other issues that could result in the common response being "not applicable". Given the timeframe for funds to provide feedback in respect of this consultation, CareSuper is currently unable to determine whether it is possible to populate these fields in the manner intended as this would require a significant engagement process with our administrator, custodian and our investment managers.

Our comments on the asset class characteristics and a number of other factors are as follows:

LOW LEVEL SAA'S NOT SET

It may not be possible or practical to fully populate the proposed low level SAAs. Categorisation of SAAs to this level is likely to be inconsistent with how SAAs are typically set across the industry.

For example, CareSuper has an SAA to Fixed Income and an SAA to Credit but not to other subsectors. We do not set an SAA for Government bonds or Private debt. CareSuper characterises Government bonds and Private Debt as a subset of Fixed Income or Credit and would be considered a level down.

Our understanding of what is proposed is noted in APRA's comment that:

> "In instances where further granularity is not required to accurately describe the investment strategy of the option, the entity would report these investment options with the *"Same as the high-level strategic asset allocation"* flag."

Given that some funds including CareSuper do not have lower level SAAs, there is a concern that the following issues could arise in relation to the data provided to APRA:

- Funds that do not provide lower level SAAs could be disadvantaged in relation to how they are categorised with reference to the split between growth and defensive assets;
- It will not be possible for APRA to compare funds using any data which relies on the lower level SAAs; and
- There may be a mismatch between the SAA categories used and AAA, suggesting a fund may need to also report AAA based on high level categories.

SAA HIGH VERSUS LOW LEVEL

<u>Fixed Income and Credit</u>

The distinction between Fixed Income, Credit and Fixed Income/Credit in the low level SAAs could be misleading and/or create confusion.

As an example, if a fund has an SAA to fixed income and credit separately, it will not be possible to compare these SAAs with a fund that combines both SAAs under credit/fixed income. This would also result in the latter fund benefiting from the appearance of a lower risk SAA compared to the fund with an explicit credit SAA allocation.

<u>Government Bonds and Private Debt</u>

The breakout of Government Bonds and Private debt as standalone SAA sectors will also potentially create confusion in the interpretation of a fund's risk profile relating to the debt related low level categories.

The classification of private debt as a standalone SAA sub-sector rather than being captured under credit is inconsistent with the classification of private equity. CareSuper would welcome further clarity in relation to this inconsistency and in relation to the carve out of Private Debt from an overall asset classification of Credit.

The use of stand-alone SAAs for assets such as Government Bonds and Private Debt appears problematic and should be reviewed in order that APRA reporting is consistent with current industry practice.

<u>Growth and Defensive Alternatives</u>

The definitions of the three types of alternatives; Growth, Defensive and Other in draft SRS 550 do not currently provide funds with a clear distinction of the differences between the three options.

This is particularly the case in respect of what is a 'growth' alternative as distinct to a 'defensive' alternative.

The current draft SRS 550.0 would not preclude a fund with an SAA to growth like alternatives choosing 'other alternatives'. As the three alternative definitions are not mutually exclusive, many of the different alternative investments could be reported in any of the three classifications.

<u>Proposed change:</u>

To ensure consistent reporting of Alternatives, it is proposed that the definitions be amended to ensure that there is no overlap in what is included under each of the three types of alternatives. Further, it will be difficult to provide such clarity without defining growth and defensive for Alternatives and therefore, how APRA proposes that these sub sectors be assessed in terms of percentage growth or defensive.

ASSET CLASS CHARACTERISTICS

Overall, the proposed asset class characteristics require further clarity and, in many cases, would be difficult to implement

Due to the inherent overlapping of what is included in each of the asset class characteristics, CareSuper is concerned about the practical application of the classifications and the ability to apportion assets between these characteristics 1, 2 and 3.

It is also uncertain if across characteristics 1, 2 and 3, it is proposed that separate amounts and exposures be provided at security level. As the Asset Class Characteristics 1, 2 and 3 definitions are not a hierarchy, any individual portfolio in any asset class could have multiple exposures to many different characteristics at different levels. For example, a multi sector credit portfolio could have exposure to almost every debt related characteristic.

	CareSuper comments
ASSET CLASS CHARACTERISTIC 1	It is not clear how some of the Characteristic 1 level categories are defined e.g. • There is no definition of large, mid, small and micro-cap for equities or if this is different for domestic versus overseas shares. • In the definition of the mid and micro-cap, it is uncertain if this is intended to be based on what each strategy is most exposed to. It would also assist funds if there was greater detail regarding how APRA will use the detailed information that will be collected.
ASSET CLASS CHARACTERISTIC 2	CareSuper notes that there is significant overlap at the Characteristic 2 level. CareSuper requests that further clarity be provided on the intent of some of the distinctions for characteristics which overlap with the other levels and what they would potentially show.
ASSET CLASS CHARACTERISTIC 3	It is not clear how some of the Characteristic 3 level categories are defined e.g. • There is no definition of short versus long term credit and bonds. • There is no definition of government Infrastructure versus non-government infrastructure and 'government' is not an accepted sector category in common market practice.

DERIVATIVES/SYNTHETIC EXPOSURE

If the intention of the proposed SRS 550.0 is to determine the breakdown of notional exposure of derivatives within each investment, CareSuper is concerned about the practical application of this change.

We note that page 7 of the draft reporting standard states:

> *When reporting indirectly held investments, apportion the value of the market exposure of any derivative contracts within the indirectly held investment to the strategic sector(s) and asset class characteristics to which the derivatives relate.*

CareSuper requests confirmation regarding whether this would require the notional exposure to derivatives at the reporting time within trust vehicles to be reported. We also would like confirmation of APRA's intent regarding the proposed breaking out of synthetic exposure versus physical exposure and how risk would be considered in terms of synthetic exposure.

The use of options strategies is an example of where this risk assessment could be challenging. Given the convexity in options, if equity options positions were active as at the end of the reporting period, the reported effective equity exposure could materially over or under-state the real risk exposure compared to physical or delta-1 type derivative positions. As it is unclear how would this be factored in when comparing exposures between funds, CareSuper requests that further clarity be provided on this issue.

It is noted in actual asset allocation, the value of the physical asset and the effective exposure of derivatives should equal the total value of investments. Does this mean funds need to show the offsetting synthetic cash positions within cash (i.e. this could show a negative synthetic cash position)?

CURRENCY EXPOSURE

CareSuper notes that the purpose of the new requirement to capture the value of assets domiciled in foreign currencies, is to allow APRA to monitor and asses funds' processes in managing risks associated with currency exposure, hedging and its impact on liquidity.

While the change does provide APRA with more information regarding currency exposure, it is the view of CareSuper that the change will not achieve the objective of being able to "monitor and assess funds' processes in managing risks associated with currency exposure, hedging and its impact on liquidity".

INVESTMENT LEVEL DISCLOSURE

The requirement to break down each individual investment into its components appears particularly onerous and difficult to practically implement.

As an example, a multi-sector credit fund alone could be broken into:

Characteristic 1 - Both IG and non-IG credit, then

Characteristic 2 - Each of those further broken down into RMBS, Structure, ABS, Other etc, then

Characteristic 3 - Each into short or long term credit.

While the additional granularity does provide further information, the complexity inherent in this exposure level reporting and the potential issues with how funds report the data will not assist in informing the aims of the Superannuation Data Transformation project of improving comparability and consistency.

As a general comment, the disaggregation of AAA position data obtained from funds' underlying investment managers at very detailed asset level and subsequent reaggregation of this information into asset allocation and growth/defensive characteristics of a fund according to APRA's investment classifications is expected to have a distortive effect. Comparison of very detailed investment level data for AAA with broader investment categories for SAA will likely create problems due to the misalignment of the basis under which the information is prepared. Further, the process relies on an assumed alignment of investment managers' interpretation of asset class characteristics which may prove to be problematic. This distortive effect may impact the quality of APRA's assessment of funds' actual positioning relative to SAA.

<u>Consultation Question 3 - Whether the additional layer of detailed strategic asset allocation reporting helps in reducing any limitations experienced in accurately reporting strategic asset allocation information.</u>

While the additional layer of SAA reporting may provide greater granularity in reporting, our concerns as outlined above in our response to Consultation Question 1 and 2, indicate that other limitations may result in some areas of the reporting.

<u>Consultation Question 4 - What difficulties, if any, may impact the ability to provide investment option level liquidity data that was required in the PDC, should APRA may include this data in the final reporting standards dependent on the learnings from the PDC? How could these be addressed or mitigated?</u>

CareSuper supports APRA's initiative to receive and monitor information regarding the liquidity management practices of funds. However, CareSuper believes that information on the liquidity characteristics of individual investment options alone does not fully inform a fund's approach to liquidity management.

It is our view that a consistent and holistic approach which takes into account qualitative measures rather than quantitative data will provide greater insight into the liquidity management practices of funds.

In considering a fund's approach to liquidity management, aspects such as the relative size of each option compared with the size of the entire investment program, the availability of derivatives to manage risk exposure and the fund's approach to rebalancing should all be considered.

With regard to the Pandemic Data Request, the option level liquidity data currently being provided is not particularly problematic to produce. Nonetheless, the time allotted for Funds to compile this information is quite short, and quality control assessments of the submission may be compromised due to this compressed timeframe.

Consultation Question 5 - The estimated cost implications from an implementation perspective of the increased frequency of submissions of Derivatives data required in SRS 550.0 from annual to quarterly, as well as the increased granularity of reporting.

CareSuper has assessed that there will be substantial costs in order to implement the increased reporting.

Cost implications will be material due to additional resources being required to comply with the new requirements as a result of:

- An increase in direct resourcing requirements at the Trustee office.
- An increase in indirect resourcing required by investment managers, administrators and custodians. and
- The additional costs associated with system changes required to both source and report the additional information.

These costs would ultimately translate to higher fees to members, directly or indirectly. Also, it is not clear to CareSuper if some of the new reporting requirements can be sourced.

CareSuper believes there is a trade-off between the timeliness and quality of the asset allocation data being provided. It is understood that the Trustee maintains responsibility for the accuracy of the data being collected. However, in the practical application, the collection and aggregation of this data is heavily dependent on the investment managers and custodian engaged by the fund.

Quality control procedures that might reasonably be applied at each step of the data collection, compilation and aggregation are compromised by the tight timeframes involved for collecting this data and submitting it. This is further exacerbated by the significant number of changes and requirements for additional, more detailed investment characteristics. In addition, service providers supporting funds will need time to make the changes that are necessary to comply with the new reporting requirement.

Consultations Question 6 - Feedback as outlined in item 4.1 Feedback sought on confidentiality proposals. Please ensure feedback is specific on which data items should remain confidential and any detriment to member or commercial interests.

As outlined in our overall comments, CareSuper is concerned that the public disclosure of detailed asset allocation and investment exposure information will compromise the interests of members, Funds and other industry participants.

DETRIMENT TO MEMBERS' OR COMMERCIAL INTERESTS

Funds invest in research capabilities, skills and investment expertise in order to form views on investments and markets, that in turn prove profitable and return enhancing for members. This intellectual property is kept confidential across the industry as much of it is competitive in nature. It would be potentially detrimental for fund members to have other funds adopt, crowd or 'free ride' off this research.

It is true that some asset allocation or positioning information is reasonably generic – such as basic SAA information. The disclosure of more detailed information that reveals actual positions or information that is competitive could be detrimental to members. Funds must be able to keep this for the benefit of their members.

Data such as counterparty names, collateral and individual investments down to detailed sub-sector with dollar value, synthetic value and currency hedging following data are highly sensitive and/or confidential. Disclosure of this information would reveal proprietary information, reveal positioning in a prejudicial manner and expose sensitive information that should otherwise not be known by market participants.

Often the ability to change an exposure or transact on a position is damaged by a market participant's knowledge of the existing position. If the market knows of an exposure, other actors in the market can 'game' your ability to trade the position. It is a well understood principle that market knowledge can, in some circumstances, directly compromise a financial outcome.

The impact of market knowledge across a fund's investment program is likely to vary greatly. In some cases, it might not be harmful for members' interests. In some instances, it is likely to compromise members' interests, depending on exactly what is disclosed.

OVERSEAS MANAGERS

CareSuper is concerned that overseas managers, in particular, will not agree to the disclosure of information that would compromise positioning or research as described above. Some managers may have few, or potentially one Australian client. Access to such manager capabilities could be compromised.

EFFECT ON COMPETITION

There is significant concern that the disclosure of proprietary information combined with the proposed investment fee disclosures in draft SRS 332.0 will have a detrimental impact on competition.

Thank-you once again for the opportunity to provide this submission. If you have any questions, please do not hesitate to contact me on [redacted] We would also welcome the opportunity to meet with you to discuss this letter further.

Yours sincerely

[redacted]

Chief Risk Officer