11 November 2022

General Manager Policy
Policy and Advice Division
Australian Prudential Regulation Authority
By email: superannuation.policy@apra.gov.au

Dear Sir/Madam

Strategic planning and member outcomes: Proposed enhancements

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on APRA's Discussion Paper on *Strategic planning and member outcomes: Proposed enhancements*.

AFMA represents the interests of over 125 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, and others across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

We see the growth of superannuation in Australia as presenting many opportunities for Australia and its economy and are observing with interest the national discussion around how such funds may be used. AFMA assess that with growth in the superannuation pool, there likely comes increased systemic financial liquidity risks, and that the national discussion needs to consider these risks as well as the opportunities. We note that at least some of the systemic risks we envision are beyond the scope of Trustee responsibilities and potentially APRA as well. Overall, we believe Australia needs to consider and analyse what a severe stress event on the superannuation system looks like, what steps could be taken to reduce the outcomes from the event, and to determine the role and importance of access to markets during such an event.

AFMA does not typically make submissions in relation to superannuation except where (as in the Your Future Your Super Portfolio Holdings Disclosure proposal), there is an interaction with the financial markets. We similarly limit our responses in relation to this consultation.

Our specific interest is in ensuring the definition of member outcomes is sufficiently broad, i.e., Question 2 in the consultation:

> 2. Has APRA correctly identified the areas for enhancement? What additional areas could benefit from enhanced requirements or guidance to support effective strategic planning and delivery of outcomes to members?

AFMA sees increasing systemic liquidity risks arising from the interaction between a growing superannuation asset pool and financial markets. We believe these liquidity risks need to be better understood across the financial system in Australia. It is easy to envisage a substantial pool of superannuation savings leading to significant changes in how finance (and markets) function domestically. As noted, this offers opportunities but also risks.

Our definition of liquidity risk in this letter refers to the ability of funds to execute (in reasonable time) intra-fund switches (e.g., from a balanced option to cash) and inter-fund switches by members; and to satisfy cash needs such as drawdowns required by members or to support margining against derivative positions.

Liquidity risks in listed investments

In listed financial markets[1] (exchanges or OTC) liquidity risk is well understood and readily observable. Many listed markets allow for assets to be sold promptly at an observable or transparent price.

Even in listed markets, liquidity risks cannot be assumed away. When the superannuation asset pool of superannuation is at $3.3 trillion[2] and projected to head to over $10 trillion by the end of the 2030s, it has the potential to dominate many local listed markets with likely negative knock-on impacts on liquidity (saleability of assets). Given superannuation funds sometimes ‘buy and hold’ assets for longer periods, we note that an ever-growing pool of investments may not lead to certain asset markets e.g., bonds and equities, reliably offering healthy traded volumes into which deals can be executed. Our view is that some markets and products currently considered as liquid, may be less so as superannuation balances grow. Should this be the case, then handling switches can be particularly challenging if many members across many funds, seek to do the same, at the same time.

Our view is that where these types of systemic liquidity risks might be present, it is appropriate to consider them in advance and how they might be managed for the benefit of the members and the broader financial system locally. The ability for Trustees to manage this systemic risk at a fund level may be limited.

---

[1] Consistent with super industry usage here ‘listed’ refers to share and public bond markets (both exchange listed and OTC) and ‘unlisted’ refers to unlisted infrastructure, unlisted property, private equity, private credit portfolios and similar.

[2] As at June 2022.

Liquidity risks in unlisted investments

Liquidity risks are far greater in unlisted investments.

In listed markets:

- pricing (and valuation) impacts can immediately be seen;
- pricing is publicly contestable;
- asset risk is publicly scrutinized through numerous release requirements;
- the number of available buyers and sellers is maximised through various mechanisms including standardised listing and quoting;
- transaction risks such as counterparty risks are minimised using clearing houses and consistent supporting documentation; and
- publicly known standardised assets are more readily accepted as collateral.

These features are of benefit to any asset class.

Many large superannuation funds now have substantial portions of their investments in unlisted assets – up to nearly a third of total assets in some very large funds, and up to 50 per cent of 'balanced' options in others.

The liquidity risks we outlined above for listed assets are substantially increased for unlisted assets. Unlisted assets are often less readily priced (and valued), and speed of exit, should a sale be needed can be slow, sometimes taking many months. Further, should quicker asset sales be needed then this may require large price discounts to be negotiated.

The risks of unlisted assets not having up-to-date pricing (valuation) are well understood, and we note APRA's current and planned work in this area. If a significant proportion of the projected trillions of superannuation investments are not valued accurately or consistently across funds, this could be a significant issue for member/ public trust in the system.

We note that there are benefits for fund members and the broader economy in the public pricing and increased liquidity (saleability) that financial markets can bring.

Where are systemic liquidity issues managed?

If systemic liquidity risks do arise this could impede the ability of Trustees to meet their obligations under SPS 515 and the Superannuation Industry (Supervision) Act 1993.

Systemic liquidity risks can be difficult for individual trustees to fully address in isolation. As such, SPS 515, being a standard for individual trustees to follow, may not be the right mechanism to address these broader but real risks. The task of understanding and formulating a response to a stress on the superannuation system is mostly beyond Trustee responsibilities.

We therefore ask that APRA consider where systemic liquidity risks in superannuation might be most appropriately addressed? We suggest Treasury may be best placed to coordinate the breadth of interests involved.

Conclusion

We thank APRA for considering our comments in relation to the Strategic planning and member outcomes consultation.

Yours sincerely

[redacted]

Brett Harper

Chief Executive Officer, Australian Financial Markets Association