the conexus INSTITUTE

ASIC discussion paper:

Australia's evolving capital markets

Submission by The Conexus Institute

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[redacted]

About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, the Institute is supported by the insights of a high-quality advisory board, who work on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Where possible research is made open source to assist industry and create transparency and accountability. Further information here.

About [redacted]

Dr [redacted] is Executive Director of The Conexus Institute. [redacted] career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. [redacted] taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio here.

About [redacted]

Dr [redacted] is Research Fellow at The Conexus Institute and an Honorary Associate Professor with the Australian National University. [redacted] career has contained distinct industry and academic phases, with investment and superannuation being two particular areas of focus. He has worked with commercial investment firms and government centres, while his academic career has predominantly been at Australian National University. [redacted] is a member of various advisory boards, including the ASIC Consultative Panel. Full bio here.

***** The authors are willing and able to participate in further consultation. *****

1. Summary

1.1. Overview of this submission

In this submission, we are selective in our comments and recommendations, rather than attempting to respond to all discussion questions. Our comments largely relate to the role of the superannuation (super) industry within public and (in particular) private markets, noting that super is the core focus of The Conexus Institute. We offer insights adding to the commentary within ASIC's "*Australia's evolving capital markets*" discussion paper that we hope may be useful, including setting out the implications for ASIC. Our submission draws on our personal knowledge and experience, and is informed by Conexus Institute's research particularly in the areas of governance, asset allocation, private markets and liquidity management.

The broad structure of this submission is as follows:

- **Section 2: Observations from our *Systemic impacts of 'big super'* report** – This section extracts and re-interprets selected findings from our research report of January 2025 ('systemic report'), noting that the full report has already been provided and presented to ASIC. We aim to connect this major study to ASIC's investigation into the role of public and private markets through the lens of the role of an increasingly large super industry.
- **Section 3: Impacts created by the YFYS test** – We explore impacts created by the Your Future, Your Super performance test ('YFYS test'), leveraging the significant body of research undertaken by The Conexus Institute on this topic[1].
- **Section 4: Super funds as a conduit for accessing private market investments** – This section argues that super funds are a natural conduit through which individuals might gain exposure to private markets. We reflect on what is required for super funds to play this role effectively.
- **Section 5: Individual investors and private market investments** – This section reflects on the issues that can arise when individual investors directly invest in private markets, noting that we refer to personal investment by individuals whether defined as retail or wholesale investors.
- **Section 6: Transparency is important for investing in private markets** – We comment on what constitutes useful transparency in private markets, acknowledging that it is outside of our knowledge set to recommend whether and how this should be made accessible to different investor types.
- **Appendix 1: ASIC's discussion questions and brief responses** – All 15 discussion questions are listed and Conexus Institute responses are briefly outlined, including noting questions on which we offer no comments.
- **Appendix 2: Liquidity stress scenarios in super** – Some illustrative modelling is presented that demonstrates how liquidity stresses in super should remain manageable provided that illiquid asset and currency hedging exposures are kept within prudent limits.

1.2. Key points

The key points we make in this submission are as follows, noting that our primary focus is around the role of super funds:

(a) Super funds play an important role in providing professional management of the retirement savings of many Australians. *See Section 2.1.*

[1] See https://theconexusinstitute.org.au/resources/your-future-your-super/.

(b) There is little case for holding significant concerns over super as a major source of systemic risk in Australian financial markets. Nevertheless, attention might be paid to the following:

- Signs that the activities of super funds could be impacting on the depth and resilience of Australian financial markets; although we consider this unlikely. *See Section 2.2.*
- Monitoring for sectors that could become vulnerable if super proves an unreliable funding source, including implications for capital markets servicing small companies. *See Section 2.3.*
- Keeping a watch out for super funds exceeding thresholds that may make them vulnerable to liquidity stress, including illiquid asset holdings of over 30% combined with high levels of currency hedging. *See Section 2.4.*
- ASIC might aim to ensure that investors remain informed about the implications of exposure to economic and market risk through super. *See Section 2.5.*

(c) The YFYS test has potential to create incentives that could have some adverse impacts. In this regard, we highlight the incentive to use leverage within private market investments and increase credit exposure as potentially boosting risk. *See Section 3.*

(d) Super funds are well suited to access private markets on behalf of their members, which stems from the industry growing in scale and establishing professional investment teams that are able to manage opaque and complex investments. However, super funds need to be appropriately structured to play this role effectively. Good governance is the 'entry ticket'. Important elements include governance of valuations, unit pricing and member equity, and management of suppliers (e.g. external managers), liquidity and foreign currency. There is a strong role for regulators in overseeing super funds in these areas. *See Section 4.*

(e) Direct investment in private markets by individual investors – whether retail or wholesale – can be quite problematic, as they tend to lack the scale and capacity to invest in private markets on attractive terms. Individual investors are more exposed to problems such as lack of information and agency risk through managers and may have less access to the better opportunities. Financial advisers reduce these risks to varying degrees. There is an even stronger role for regulators like ASIC in protecting individual investors that access private markets. *See Section 5.*

(f) We suggest that a key aim for ASIC from this consultation and the process that follows would be to make private markets a safer place to invest, especially for individual investors. Increased transparency through improved disclosures might be a major component. Measures that reduce potential for conflicts of interest could also be worthwhile. *See Section 6.*

2. Observations from *Systemic impacts of 'big super'*

Our systemic report makes various observations that are relevant to the topics addressed in the ASIC's *Australia's evolving capital markets* discussion paper. This section 'connects the dots' by extracting selected insights from this report and relating them to the matters that may be of interest to ASIC in the context of the current consultation.

2.1. Super funds as professional managers of investments

Key benefits to arise from the emergence of a big super industry containing some big funds stems from the manner in which super has led to the establishment of a large pool of retirement savings that is being professionally managed on behalf of the vast majority of Australians. In particular, super funds have developed investment capabilities through establishing internal teams to oversee portfolios, including both the selection and monitoring of external investment managers and possibly in-house investment. This brings a number of benefits (and issues) for the Australian economy, financial markets and Australians. The benefits most relevant to ASIC's current consultation include the following:

- *Members have access to informed fiduciaries to look after their savings* – If the super industry did not exist in its current form, many Australians would need to manage their own investments. This would entail undertaking tasks such as selection and oversight of any providers including investment managers for which they may be poorly suited, and where in some instances the provider may have less alignment with investors than do super fund trustees.

- *Better stewardship* – One consequence of the development of internal investment teams (along with judicious use of asset consultants) is that super funds are well-positioned to act as stewards of their investments. This is very relevant with respect to overseeing other agents within the system, in particular external investment managers when outsourcing. It can also enhance oversight of company management.

- *Rounding out the sources of funding* – Large super funds are able to provide funding to Australian businesses of a type that might not otherwise be broadly available. The broadening of funding sources emerges as a consequence of a combination of having scale to invest in assets where access to large licks of long-term capital is desirable, possessing internal capabilities to invest in certain assets (most notably private markets), and the pooling of long-term savings across many members. Pooling of members helps to limit the requirement to be able to readily access liquidity[2], which supports the ability to be suppliers of long-term patient capital.

Implications for ASIC: The above features make super funds particularly well suited to investing in private markets – provided that they are configured appropriately. Ensuring the latter is where regulators such as ASIC and APRA (i.e. the Australian Prudential Regulation Authority) have a role to play. Section 4 discusses these matters in more depth.

2.2. Common investment approaches and market depth and resilience

Our systemic report addresses the propensity for super funds to invest in a similar fashion and the potential implications. Super funds are encouraged to pursue common approaches to investing by a combination of influences, including the manner in which performance is assessed (including the YFYS test and peer-relative comparisons), the dominance of the strategic asset allocation (SAA) approach to forming portfolios, and a range of shared investing practices. This raises the question over whether super as a large and growing investor class that operates in similar ways might have adverse impacts on the depth and resilience of Australian capital markets, notably certain public markets such as Australian equities.

The conclusion in our systemic report was that there is scope for a large super sector to have some impact on market behaviour, but the impacts are unlikely to significantly undermine market depth and resilience. Reasons include:

- A wide range of investors operate within Australian financial markets. Super funds are not yet sufficiently dominant to undermine market depth and resilience. For example, the Reserve Bank of Australia (RBA) estimates that larger super funds hold around 20% of Australian equities and corporate credit[3], implying that 80% is held by other investor types. Overseas investors in particular are one investor type with scope to supply or withdraw significant amounts of capital if Australian markets happened to get out of kilter due to the action of super funds.

- Super funds tend to undertake a significant amount of active management, and do not invest in exactly the same manner when doing so. Both the internal teams of larger super funds and the investment managers they employ adopt a range of investment styles.

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[2] The pooling of members reduces the likelihood of funds being in significant net outflow as some members are contributing while others withdraw. We further discuss liquidity in Section 2.4.

[3] Refer page 40 of the RBA's *Financial Stability Review* of April 2025. These estimates exclude self-managed super funds.

- There is a natural limit on the extent to which super funds will come to dominate Australian markets. As super funds increase in size and 'outgrow' a given market (i.e. encounter capacity constraints), they are likely to be forced to diversify into other markets. It is highly likely that more assets will be directed into overseas investments as the sector grows. In fact, large funds such as AustralianSuper and ART have indicated that this is their intention.

Implications for ASIC

The discussion above cautions against expecting substantial impacts from a large super sector on the depth and resilience of Australian financial markets. We hence suggest that ASIC not place a high level of focus on this issue[4]; although a watch of this issue might be maintained.

2.3. Super as a reliable source of funding

Our systemic report raised the issue of whether super might be an unreliable source of funding for some sectors. Two main matters were raised:

- *Hollowing out in the small company sector* – Super funds will have increasing difficulty and decreased incentive to invest in small companies as they grow, in part because position sizes in individual small stocks will be limited to levels that 'do not move the dial'. A key concern is that this hollows out institutional involvement in the small cap sector and capital availability supplied to smaller companies, with implications for not only ability to source funding but also (more importantly) supporting infrastructure including analyst coverage, monitoring by informed investors, market making facilities, and so on. The risk is that small caps are turned increasingly into a retail-driven sector, which could have an adverse impact on market efficiency. A key question is the extent to which other informed participants might fill the void.
- *Feast and famine funding in certain sectors* – The willingness of super funds to invest and supply capital to a sector may fluctuate over time for a range of reasons, including:
  - Judgements around the relative attractiveness of the sector as an investment
  - Behavioural influences, e.g. return chasing; investment fads, including desire to be seen as associated with hot sectors and not involved in poorly performing sectors
  - Public perceptions of the sector, e.g. avoiding sectors considered detrimental to society

  As a consequence, there is scope for 'feast and famine' involvement in some sectors by super funds that could drive boom-bust cycles. This is especially the case for 'non-core' sectors where involvement is somewhat discretionary, e.g. sub-sectors of credit markets.

Implications for ASIC

ASIC may want to monitor for asset classes where super funds are important players and could feasibly significantly scale back or withdraw their involvement, as the underlying markets may prove to be fragile. No such sectors are evident at present, although a watch might be kept on some parts of domestic private credit from this perspective.

2.4. Systemic liquidity stress unlikely to emanate from super … but some risk that individual super funds could be exposed

Liquidity management and potential for liquidity stress in super has recently been under focus by regulators. For instance, the APRA has given super funds a mixed report card on liquidity management practices; and is planning to conduct system-wide stress tests where liquidity issues are likely to play a central role. The RBA notes in its *Financial Stability Review* of April 2025 that there is *"potential for financial system stress could be amplified if the superannuation sector faced*

[4] We are more concerned that passive index investing could cause a deterioration in market depth and resilience at some point; although Australia is currently some distance from levels that might cause concern.

severe liquidity stress ... If several risks materialised simultaneously" (see page 44), albeit suggesting that *"extreme but plausible conditions"*[5] were required for this to occur.

Our systemic report broadly aligns with the RBA's stance by concluding that systemic liquidity stresses are *not likely* to emerge from the super industry, albeit they remain a *possibility*. If anything, we are more sanguine than the RBA on the basis that the confluence of events required for liquidity issues within super to escalate to a systemic level is ***quite unlikely***[6]. Nevertheless, we do see a larger risk that an individual fund could encounter liquidity stresses that cause harm to its members, in particular if some event triggered widespread switching out of that fund (i.e. a 'run' on the fund). Key considerations in assessing the extent of liquidity risk in super (around which the Conexus Institute has conducted in-depth modelling) include:

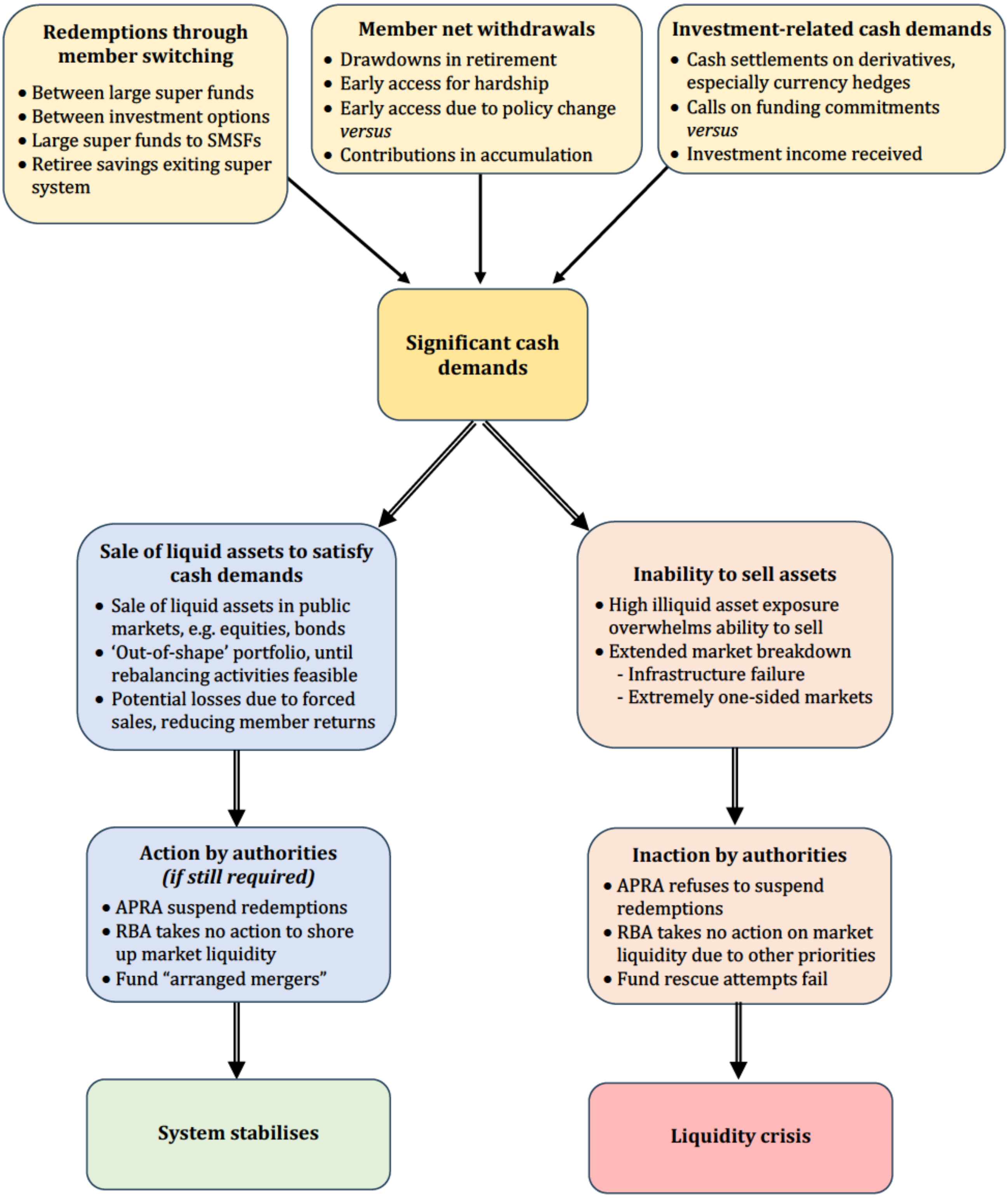
- Liquidity stress for super funds can arise from a number of sources:
  - Member activity, with potential sources including: switching between funds or investment options; funds withdrawn in retirement; access to super under hardship or due to policy change (e.g. early release); after allowing for the offset from new contributions.
  - Cash settlements on derivative contracts, with foreign exchange hedging being notable for offering the greatest potential for significant cash settlements (upon a decline in the A$).
  - Cash calls on commitments in private markets, e.g. private equity.
  - Difficulty in liquidating assets to satisfy the liquidity requirements, which increases with exposure to illiquid investments notably including private markets.
- Super funds may sell their liquid assets if the need arises to generate liquidity, the main consequence of which would be an 'out-of-shape' portfolio that would need to be addressed over time. At current levels of illiquid assets weights, which typically sit below 30% with a few exceptions (see Figure 2 below), super funds have considerable scope to address liquidity pressures while avoiding the more dire consequences through sale of liquid assets according to our modelling.
- One caveat is that liquid asset markets remain capable of absorbing any selling by super funds. Here the main concern is not that assets are unable to be sold, but rather that member returns are reduced by super funds being forced to sell assets at unattractive prices. It would probably require a major disruption to market infrastructure for a complete market breakdown in assets like equities and government bonds that denies liquidity to funds. If any such major disruption were to happen, it seems quite improbable that would occur for an extended period of time.
- The likelihood of widespread redemptions from super are low, in a large part due to inactivity by members. Further, at a system level, the assets need to remain within super during accumulation so that any switching would be between funds. This tendency for switching between funds rather than exiting super might continue into the retirement phase to some degree. Any propensity for problems to result in switching between funds has the implication that liquidity risk will tend to be greater at the individual fund than the system level.
- A policy change permitting greater access to super during accumulation could shift the goalposts. By how much depends on the nature of the policy and how it is implemented.

[5] The RBA states on page 40 of the Financial Stability Review that "*Structural features of the Australian superannuation sector help mitigate its direct threat to financial stability; however, in extreme but plausible conditions it could potentially pose an indirect threat by amplifying shocks in the financial system.*"
[6] Part of our case is that APRA or the RBA may take action to address any liquidity stresses that amount to a systemic threat. We note that neither APRA nor the RBA are likely to flag the possibility they might do so.

Figure 1 summarises these concepts. The yellow boxes at the top capture the potential drivers of liquidity needs. At the bottom are two paths that might result. The lower left branch is the more likely sequence in our view, in which case a liquidity stress scenario would be avoided. The lower right branch captures the various stage-gates that the system (or a super fund) needs to pass through before a liquidity stress scenario occurs. We consider this sequence as unlikely. We note that Figure 1 contemplates responses from the regulatory authorities, which the regulators themselves may understandably not be willing to flag as a possibility.

Figure 1 might also be reinterpreted from an individual fund perspective. In this instance, 'switching between funds' may loom larger where a fund encounters its own specific problems.

Figure 1: Drivers and response to liquidity demands in super



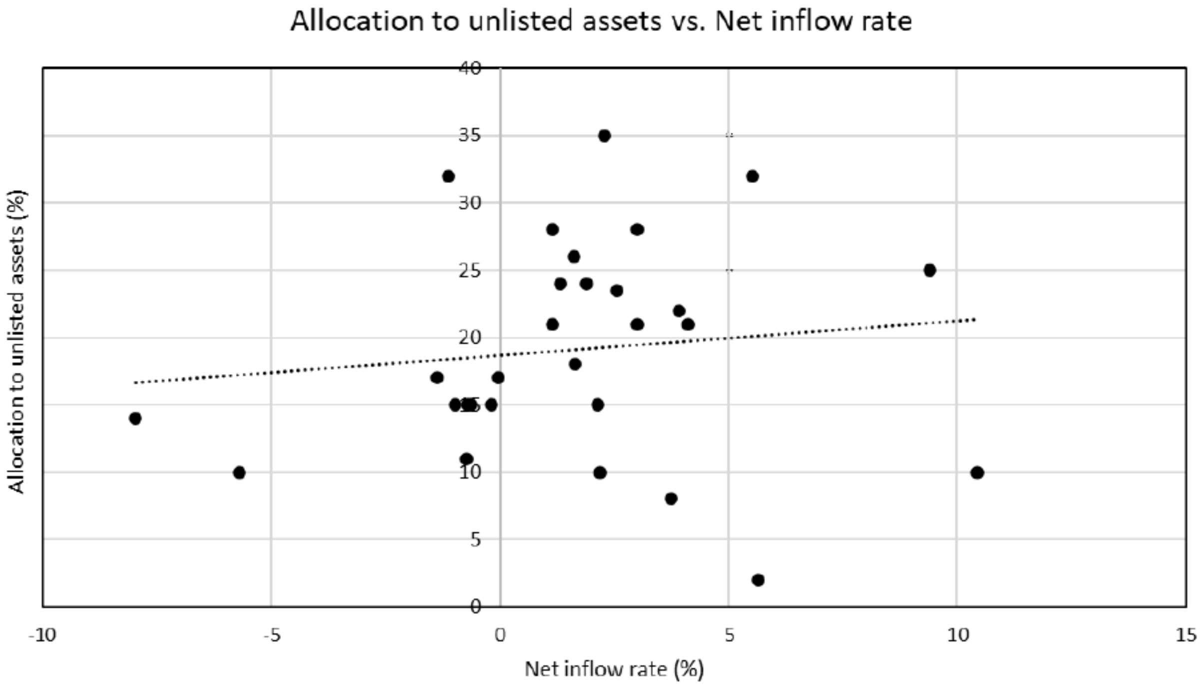
Conexus Institute modelling confirms that individual super funds are unlikely to encounter a significant liquidity stress scenario given their exposure and a feasible range of possibilities for market movements and members outflows. Detailed analysis we have previously conducted finds it hard to generate a high-impact liquidity stress scenario for an individual fund even allowing for relatively high exposure to unlisted assets and currency hedging, asset market weakness and member outflows. This analysis is summarised in Section 5.3 of our systemic report.

Figure 6 in Appendix 2 further illustrates our analysis, presenting a more limited example through two scenarios entailing a 'standard' and 'difficult' degree of weakness in investment markets and the A$ along with net member outflows. Assuming a fund faces into these scenarios with 30% illiquid assets and 50% invested overseas with 50% currency hedging leads to illiquid weights moving to a 'manageable' 35% and 42% of the portfolio as a consequence of selling liquid assets to meet liquidity needs. This broadly reflects where the super industry currently stands. Raising illiquid assets to 40% and currency hedging to 75% results in illiquid weights moving to 47% and 57%, which might be considered 'traumatic'. The main message is that the risk of major liquidity stress should remain limited providing that super funds do not push the envelope too far on either illiquid asset or hedging exposure while public markets continue to supply liquidity as required.

The risks are more limited at the system level to the extent that the assets remain within super, most notably in accumulation. However, super funds could still contribute to either broader weakness in markets to the extent that they are coordinated forced sellers. On the other hand, they might equally act as a stabilising force (as they did during the GFC). Much depends on how any situation unfolds.

The prudent allocation to illiquid assets should also be informed by the net inflow position of funds. The Conexus Institute observes sizable differences in fund inflow rates (see Figure 2, which references FY2022 data[7]). Anecdotally we are concerned that some funds place more weight on peer group allocations than their own cash flow profiles as an input into the determination of their own asset allocation targets.

Figure 2: Snapshot of liquidity management of super funds



[7] This was published in an Investment Magazine article titled *"There's much more to governance of unlisted assets than valuation"*.

Implications for ASIC

We suggest that liquidity risk within super is not considered a matter of significant concern *as long as* illiquid asset weights remain below a notional marker of 30% and currency hedge ratios are not elevated too far above 50%, at least for funds not in natural outflow[8]. ASIC (and other regulators) might pay more attention if illiquid asset weights and hedge ratio creep above these notional markers, perhaps then focusing on the integrity of the liquidity management practices in place[9]. For example, the positioning of a few of the funds with illiquid exposures above 30%, especially the fund experiencing negative inflows, might warrant regulatory 'check-ins'.

2.5. Economic and market exposure as an over-arching consideration

Super effectively boosts the economic and market exposure of members through their retirement savings, noting that the sector's weight in growth assets stands at around 70%. A generous level of exposure growth assets is entirely appropriate as it boosts expected returns and hence expected outcomes (e.g. retirement income) for members. However, it also doubles up member exposure to unlikely yet feasible scenarios entailing extended weakness in the economy and hence financial markets, given that members may also have exposure through their employment and other assets including possibly housing. In holding relatively high weights in growth assets, super also increases the overall risk exposure within the financial system.

A related question is whether super fund exposure to private assets might offer portfolio benefits, especially through dampening exposure to economic and market risk by providing diversification, given that equity market fluctuations tend to dominate portfolio volatility. While this may be the case to a degree, we caution against overstating the portfolio benefits for the following reasons:

- As portfolio exposure to economic and market risk tends to transcend both private and public assets to a substantial degree, the extent to which genuine diversification benefits are available from private markets over the medium-long run is unclear. Common underlying exposure to broader economic and market-wide events can arise through impacts on both cash flows and potential exit values. Economic factor exposure may be a better way to view exposures, e.g. to what extent are assets sensitive to economic growth or interest rates.
- Smoothed returns through appraisal valuations largely apply over the shorter-term, and may provide an illusionary degree of diversification for the medium-long run.
- Risk in some private markets can be exacerbated by both use of leverage embedded within investment vehicles and the illiquidity of the underlying investments. This combination could magnify losses in an economic and market stress scenario, especially where a loss of funding support from either lenders or investor redemptions (where available) create compulsion to liquidate assets. Leverage is often combined with low liquidity in the case of private equity, property and infrastructure.
- The return distributions of private market assets can be influenced by fees, which tend to be high and often structured as 'base plus incentive' fees. These structures introduce a higher hurdle for value generation, while skewing the distribution by truncating the upside (investors

[8] Net natural flows should be monitored by regulators to inform the oversight of fund liquidity management; although this seems to fit within APRA's remit.
[9] For further discussion, see our article "*Super funds get special privileges around unlisted assets they need to respect*" in Investment Magazine on 6 February 2025. Of interest, we also note that under the Corporations Act, a managed investment scheme that holds 20% or more in illiquid (or unlisted) assets is deemed an illiquid scheme and is restricted from providing frequent liquidity.

are essentially granting the manager an option). In the absence of attractive returns from the underlying assets that more than offsets the fees, investors may find that private market assets deliver relatively low wealth generation over the long run that dilutes the value of diversifying.

Implications for ASIC

ASIC's role in financial product oversight is particularly relevant in private markets given their opaque nature. We accordingly wholeheartedly welcome the current investigation into this area. Here we see a role for ASIC in ensuring that investors are fully informed about the risks associated with investing in private markets through either requiring appropriate disclosures by providers (see Section 6) and education (e.g. through Moneysmart). This might include requiring that underlying exposures are conveyed, including the risk that assets may deliver poor long-term returns under adverse economic or market scenarios, that diversification benefits are not being overstated, and that the implication of fees for potential returns is properly described.

3. Impacts created by the YFYS test

The YFYS test was first applied to MySuper products at the end of FY2021, is administered by APRA and is applied annually. The testing universe has been expanded to cover all trustee directed super fund products (multi-sector offerings). Broadly the test is designed to assess the relative return performance of a fund's implementation of its SAA. This has led to many critiques, most notably the risk-agnostic nature of the test, the ignorance of the SAA decision itself, and a focus by funds on 'YFYS tracking error'.

Despite its flaws[10], there appears little industry appetite to change the YFYS test. There seems to be a sentiment that industry knows how to 'manage the test'[11], evidenced by no failures in the most recent test results.

A number of nuanced effects of the YFYS test may be relevant in the context of ASIC's review into capital markets:

- **Incentives for funds to increase leverage in unlisted exposures** – The fact that the YFYS test assesses fund performance against representative indices creates an incentive to at least match the leverage embedded in the benchmarks, and perhaps run higher 'beta' to increase the likelihood of outperformance. This can mean running leverage either at the individual asset level or at the strategy level (on a non-recourse basis).
- **Incentive to increase credit risk exposure** – Credit risk exposures including private debt receive favourable treatment in the YFYS test by being benchmarked against a public credit index with an investment grade credit rating. Increasing credit risk gives access to a higher running yield that provides a good chance of outperforming the benchmarks, to the extent that any default losses have traditionally been much less than the spread and market-wide default episodes occur only occasionally.
- **Challenges with private equity** – Private equity exposures are benchmarked against public market indices, which potentially distorts private versus public market capital allocation decisions. For example, the YFYS test does not account for the j-curve nature of private equity investments (whereby performance is often flat to negative while capital is being invested and operational changes are taking effect).

[10] We acknowledge that there are benefits to a 'bright lines' performance test; and that the YFYS test has contributed to fee reductions and improved investment governance structures.
[11] The Conexus Institute is aware of various techniques to improve the likelihood of passing the YFYS test.

- **Lack of separate benchmark for small companies** – Australian equities are benchmarked against the S&P/ASX300 benchmark. While this incorporates small companies (generally defined as outside the top 100), it does little to encourage separate allocations to small companies. This can exacerbate the lack of support for this sector (as discussed in Section 2.3).
- **Super funds are anchored to market benchmarks, particularly in public markets** – The degree of anchoring is governed by the amount of performance test buffer (accrued outperformance). A simple example is global developed market equities, where the benchmark index has around 70% exposure to US equities. While a more diversified portfolio may be appropriate, funds would likely find it difficult to substantially reduce their US market exposure.
- **Forced FX selling when global markets fall** – When global asset markets fall in value, funds may need to reduce the nominal dollar amount of FX hedging to maintain their benchmark SAA hedging level (against which they are assessed under the YFYS test). This could require reducing currency forward positions at the same time that the AUD is behaving in a pro-cyclical manner (i.e. declining along with 'risk' assets like equities). This creates a situation where super funds might contribute to selling pressure on the AUD during difficult market environments.
- **Hampers long-term investing** – Many funds believe that their capacity to act as long-term investors is impaired under the YFYS test, with potential impacts on market structure. Some of the quotes by super fund CIO's[12] reflect this concern:

"Longer horizon investing was a real advantage, but YFYS takes that away"

"Are we genuine long-term investors? No more"

The likelihood of significant changes to the YFYS test is low. There have already been multiple reviews with only minor changes. Politics, complexity and (more recently) industry resistance make major changes difficult to implement.

Implications for ASIC

It may be helpful for ASIC to remain cognisant of the potential influences that may flow from the YFYS test in conducting its review of public and private markets. The incentives created by the YFYS test to increase the use of leverage and credit exposure may be of particular interest, to the extent that it may raise risk in some products beyond what might be prudent.

4. Super funds as a conduit for private market investing

In this section we argue that super funds are a natural conduit through which individuals may gain access to private markets, provided that funds are structured to effectively play this role. Section 4.1 starts by setting out the reasons why super funds are a natural conduit for exposure to private markets. Section 4.2 highlights some limitations in super funds playing this role, and issues to address if they are to do so effectively.

4.1. Why super funds are a natural conduit for providing exposure

Super funds emerge as a natural conduit through which individuals can gain access to private markets as an extension of their status of fiduciaries that professionally manage significant amounts of savings on behalf of Australians. Their suitability for this role also stems from the opaque and complex nature of private markets, which calls for professional oversight of

[12] Reference: *Assessing the impact of YFYS through interviews with CIOs of funds with performance "buffer"* by The Conexus Institute.

investments including managers. Figure 3 lists characteristics of private markets, including both benefits and issues and challenges of investment.

Figure 3: Characteristics of investing in private markets

Benefits	Issues and challenges
• *Diversification*, although often overstated as economic exposures persist – see below • *Inflation hedging* (some assets only) • *Additional source of excess returns* - More related to 'control' over assets abetting the ability to add value to assets[13] and then capturing the value in valuation uplift - Possible existence of illiquidity premiums, although this is debatable[14] • *Behavioural benefits*, including - Smoothed returns helping to reduce stress and sustain confidence - Commitment of funds reduces opportunity to overreact to volatility • *Scope to combine public and private market counterparts*, e.g. unlisted property and REITs - Assists in maintaining asset class exposure - Provides arbitrage opportunities	• *Opaque and complex*, i.e. complicated structures and low transparency • *Information asymmetry* between investors and managers • *High fees and costs* - May come in various forms, e.g. base plus incentive fees; managers allocating costs to fund; high search and transaction costs - Incentive fees provide options to managers • *Specialist skills needed* to generate excess returns through adding value to assets, and thus capture a valuation uplift • *Accessing opportunities is crucial* - Access to attractive assets - Access to skilled managers • *Illiquidity*, which needs to be managed • *Portfolio construction and risk management complexity*, requiring uplifted portfolio and risk management skills and systems

The aim when investing in private markets is to capture the benefits while addressing the issues and challenges listed in Figure 3. Super funds, especially larger funds[15], are potentially well-placed for the following reasons:

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[13] This is a key distinction versus public markets where excess returns are generated by being able to anticipate shifts in asset values in the marketplace, i.e. 'out-guessing the market'. Meanwhile, anticipation of value-add by a company through (say) good management tends to be discounted in market prices (although activist investing can create value in some instances.) For a discussion of value-creation and capture in private markets, see Kaiser, R.W., "Analyzing real estate portfolio returns", *Journal of Portfolio Management*, September 2005, 134–142.

[14] There is limited evidence that private markets offer higher returns than public markets as a consequence of illiquidity premiums; although illiquidity premiums are evident in public markets. This appears due to private market participants typically having tolerance for illiquidity and hence being willing to accept illiquidity without demanding a premium. In contrast, public market participants appear to value liquidity to a greater extent. (Some references can be provided on request.)

[15] For a discussion, refer Lawrence, S. and Warren, G., "Do Superannuation Fund Members Benefit from Large Fund Size?", *Conexus Institute*, 24 March 2023.

a) *Internal capabilities* – Most of the larger super funds have professional investment teams including private market specialists that can select and oversee investments and managers. These teams are effectively doing due diligence on behalf of members.

b) *Better capacity to address agency issues* – Much investment in private markets involves drawing on external management. This may be either through outsourcing to external managers, co-investment alongside a manager, or employing an external party to manage an asset under direct co-ownership. This gives rise to considerable exposure to agency risk, which is heightened by opaque markets and information asymmetry between investors and managers. Super funds can position to manage the agency issues through establishing internal teams to perform the following tasks:

   – Manager selection, including identifying managers that are skilled at performing their role

   – Overseeing and negotiating fees and other costs charged by managers

   – Monitoring performance, including scrutinising valuations where required

   – Appointing board representatives when there exists a substantial stake in a private asset

c) *Access* – Success in private markets often requires access to skilled managers and/or attractive investments, which is abetted by networks and relationships. Super funds, especially larger funds, have the resources to build these networks and relationships through their internal teams and presenting themselves as reliable sources of long-term stable capital. Moves to establish overseas offices by AustralianSuper, ART and Aware Super are examples of funds working to enhance their access to good opportunities.

d) *Accommodating assets with large unit size* – Property and (especially) infrastructure require large portfolios to access some assets while maintaining adequate diversification. Larger super funds are best placed to build well-diversified portfolios in 'big ticket' asset classes, especially where direct rather than pooled investment is part of the mix.

e) *Portfolio and risk management* – Super funds are able to invest in the staffing, systems and processes to manage integrated portfolios of public and private assets. This enables them to have a better understanding of the risk and exposure profiles of their portfolios.

f) *Illiquidity management* – Super funds are able to absorb a certain level of illiquidity by virtue of being perpetual vehicles with relatively stable funding. Section 2.4 discussed exposure to illiquidity, highlighting how combining liquid and illiquid assets can help address liquidity risk through deploying liquid assets to meet liquidity needs ('liquidity pooling'). Super funds can build liquidity management systems to manage cash flows including any drawdowns on commitments that is a feature of some private markets.

g) *Limiting fees* – Larger super funds have scope to reduce fees through direct and co-investment, and perhaps occasionally through negotiation.

Implications for ASIC

ASIC (and APRA) might seek to support super funds in accessing private markets on the basis that it can benefit many Australians. We suggest focusing on ensuring that super funds are configured to play this role effectively (discussed below in Section 4.2), and then rely on super funds to manage private market investments effectively if appropriate structures are in place. That is, we caution against being overly prescriptive with respect to regulation and placing disclosure requirements on super funds, while placing more reliance on ensuring good governance and that super funds are operating in members' best interests. However, we do consider that some standards may help guide the industry, under which funds can implement as they see appropriate. This might be augmented with requiring that super funds maintain an adequate level of disclosure around their practices in private markets, in particular with regard to governance (see Section 4.2) and portfolio structure and holdings.

4.2. Issues for super funds in playing an effective role in private markets

Section 4.1 outlined reasons why super funds are a natural conduit through which individuals may gain access to private markets. The ability of funds to perform this role effectively is not automatic. First, they need to be structured appropriately. Second, super funds face a number of hurdles in extracting value from private markets (as do other investors). We initially outline the main required capabilities before highlighting the hurdles.

Required capabilities

The required capabilities listed below effectively sum to ***good governance***, which we view as the 'entry ticket' to exploiting the potential in private markets while avoiding the pitfalls. Most of the capabilities listed below are covered by APRA's Prudential Standard SPS530 *Investment Governance in Superannuation*.

- *Valuation governance* – Valuation governance impacts directly on performance measurement and unit pricing, which in turn has implications for member equity upon entry and exit. Strong valuation governance can help to overcome the opaque nature of private markets and respond to the possibility that disclosure and valuation practices by managers can often be poor.
- *Management of suppliers, i.e. outsourcing to managers* – Funds need to establish the capacity and procedures for selecting, accessing and monitoring suppliers used in private markets, especially managers. Ensuring value-for-money given high fees is important for success. Identifying skilled managers while closely monitoring fees and costs is central, given that managers can extract value for themselves in many ways. Staff with the appropriate skills are essential.
- *Liquidity management* – Super funds need to have procedures in place to manage the illiquidity associated with private markets, including impacts across the broader portfolio (e.g. rebalancing) and handling uneven cash flows including any calls or returns of capital. Liquidity management becomes increasingly critical as the weight in illiquid asset increases: 30% weight was suggested above as our notional threshold for potential concern (see Section 2.4).
- *Currency exposure management* – Much of the investment in private markets is directed overseas, giving rise to the need to manage exposure to foreign currency. The hedging decision is central. In addition to the implications for investment returns and risk, hedging can give rise to cash flow effects[16] that can become significant upon major currency moves. The issue that arises is the cash flows effects of hedging become more difficult to manage where hedging is combined with illiquid assets that cannot be readily sold (and other sources of liquidity are not readily available. e.g. ability to sell liquid assets). It is thus important that super funds have a capacity to manage their currency exposure and any liquidity effects related to hedging, especially where hedging is related to investment in illiquid overseas private assets.
- *Frameworks for member equity* – Super funds should have frameworks to manage member equity. Suitable governance over valuations and unit pricing is one aspect. Others include the terms under which members may enter or exit options during times of extreme stress (which

[16] Unhedged positions retain exposure to fluctuations in the value of foreign currencies versus the A$ in addition to asset returns in local currencies. Hedged positions neutralise the foreign currency exposure, with local currency asset returns then adjusted by the interest rate differentials embedded in forward contracts. Hedging can give rise to cash flows effects, with a rising A$ delivering gains and cash payouts and a falling A$ resulting in losses on the hedge to be covered in cash. Hedging exposures can be significant if combined with illiquid assets that cannot be readily sold and other liquidity sources are unavailable.

may create out-of-shape portfolios), valuation uncertainty, and implications of liquidity pooling across investment options (the 'banker option').

Hurdles

Some hurdles may limit the effectiveness of investing in private markets for super funds, even though the required capabilities as outlined above may be in place.

- *Fees are high* – Figure 4 extracts estimates from a recent study for 10 private markets of total fees as well as gross and net returns (measured as internal rate of return, or IRR). The estimates are constructed with reference to reported net returns and the terms that govern fees, along with assumptions about timing of cash flows. The estimates suggest that many private markets have delivered attractive gross returns, but once fees broadly in the 5%-8% region are deducted, net returns are often far more pedestrian. This underpins the importance of ensuring value-for-money in private markets by identifying managers that are capable of generating returns that more than exceed their fee.

Figure 4: Estimates of returns and fees in private markets

	Average			Median		
	Gross IRR	**Fees**	**Net IRR**	**Gross IRR**	**Fees**	**Net IRR**
Private equity						
Buyout	25.3%	9.7%	15.6%	22.8%	7.9%	14.0%
Venture capital	24.7%	10.8%	13.9%	24.0%	8.5%	13.2%
Real assets						
Energy	7.7%	8.3%	-0.6%	8.7%	7.3%	1.1%
Infrastructure	15.4%	6.6%	8.8%	13.3%	5.1%	8.0%
Natural resources	7.8%	7.5%	0.3%	4.6%	5.3%	0.7%
Real estate						
Core-plus	12.8%	4.7%	8.2%	12.8%	4.7%	8.2%
Opportunistic & value-add	18.2%	7.1%	11.1%	19.4%	7.3%	11.7%
Private debt						
Direct lending	12.5%	5.2%	7.3%	12.1%	5.0%	7.8%
Real estate credit	12.3%	5.3%	7.1%	12.4%	5.6%	8.0%
Special situations credit	15.1%	6.5%	8.6%	13.2%	5.0%	8.2%
Summary statistics						
Average	*15.2%*	*7.2%*	*8.0%*			
Median				*13.0%*	*5.5%*	*8.1%*
Minimum	*7.7%*	*4.7%*	*-0.6%*	*4.6%*	*4.7%*	*0.7%*
Maximum	*25.3%*	*10.8%*	*15.6%*	*24.0%*	*8.5%*	*14.0%*

Notes: Estimates extracted from Lim, W., 2024, "Accessing Private Markets: What Does It Cost?", *Financial Analysts Journal*, 80(4), pp.27-52. The author builds a model that imputes fees and hence gross returns with reference to reported net returns and terms governing fees along with assumptions about timing of cash flows.

- *Competition for access* – Strong competition for access to either assets or skilled managers can hamper super funds in accessing high returns in private markets. One example of the impact of competition for access is unlisted infrastructure, where assets may trade at a premium to listed counterparts due to many asset owners targeting significant direct allocations to the sector. Another is example is that the better private equity managers tend to be more available to investors with whom they have existing relationships. This can freeze out many super funds (especially smaller funds), who in turn may only have access to less skilled managers.
- *Limited bargaining power with managers* – One consequence of competition for skilled managers is that managers often hold the upper hand in negotiations. This allows them to continue extracting higher fees and consequently capture the bulk of the value-add for themselves (as illustrated in Figure 4). It can also limit the extent to which managers may be responsive to

requests around providing more transparency or tailoring their valuation processes to Australian investors.

- *Natural constraints on private market weights* – Super funds face some natural constraints on the extent to which they can prudently invest in private markets, which may limit their ability to extract the maximum benefit. Constraints will be fund-specific, and may include the following:
  - Many funds are near our notional threshold of 30% exposure to illiquid assets, especially for the larger profit-for-member funds. There hence may be not much room to prudently increase private market weights for these funds, for which further investment will arise from recycling of existing committed capital and allocating any inflows available to invest.
  - Some super funds might remain constrained by specific circumstances such as lack the scale or capabilities to invest in some private markets, most notably smaller funds.
  - Some funds should ideally be restricting their illiquid exposure due to less secure funding under their business model and/or the nature of the member base. Illiquid asset exposure has traditionally been more challenging for retail platforms due to the operating models of these funds. Funds in outflow due to having more members in retirement might have less tolerance for illiquidity.
- *Single-sector illiquid options are fraught* – Single sector illiquid options are more exposed to the risk of outflows due to members redeeming their investment, which may occur if the option underperforms or the sector falls out of favour. Combining capacity for investors to redeem at call with underlying assets that are illiquid has always been a flawed and risky strategy[17]. However, some super funds provide such options and use the largest investment option (commonly the MySuper option) to absorb the liquidity requirements of the single sector option (sometimes called 'the banker option' model). In effect this creates various governance and member equity challenges in exchange for addressing the illiquidity risk.

Implications for ASIC

Regulators such as ASIC and (in particular) APRA should keep a watch on the super funds to ensure that the required capabilities are in place for effective investment in private markets. Areas that deserve close attention include valuation governance, processes to ensure member equity, and liquidity management; as well as oversight aimed at ensuring that super funds have in place well-resourced and skilled internal management teams. Areas that regulators might keep a watch out for as flags of potential vulnerabilities include:

- Illiquid asset exposure of above 30% in balanced funds (perhaps adjusted for the degree of natural flows and security of funding)
- Offering of single-sector illiquid options through any fund, but particularly retail platforms
- Combination of high levels of currency hedging and illiquid assets
- Poor valuation governance

5. Individual investors and private market investments

Direct investment in private markets by individual investors can be quite problematic. Unlike super funds which can use their scale and internal management teams to access private markets on behalf of their members, individual investors are relying on themselves and/or other agents such as financial advisers (along with their associated research teams and consultants) to assist them. Individual investors are less likely to reap the full benefits and are more exposed to some of the problems of investing in private markets as a consequence.

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[17] A historical example is the implosion of the unlisted property trust sector in the early 1990s.

Here we make little distinction between retail and wholesale investors. We consider that the wholesale investor test does little to identify truly sophisticated investors on a consistent basis. While there will undoubted be some very sophisticated investors within the wholesale category, we suggest that ASIC operates on the assumption some wholesale investors may lack an appropriate level of sophistication and accordingly should be afforded a similar level of protection to retail investors. As such our discussion applies to both investor types, unless stated otherwise.

Figure 5 lists the flash points where individual investors face additional issues in private markets relative to super funds and other asset owners.

Figure 5: Issues faced by individual investors and financial advisers in private markets

Benefits more difficult to access	Challenges that are heightened
• *Diversification* may be hampered by having lower amounts to invest, e.g. individual investors may be required to concentrate their exposure through a limited number of funds or managers. • *Additional sources of excess returns* through adding value to assets and capturing the valuation uplift is more difficult to achieve to the extent that skilled managers may be less readily available to individual investors.	• *Effects of opacity, complexity and information asymmetry* are amplified as many individual investors and some financial advice groups are less well-informed and face lower transparency. Individual investors and financial advice groups can be less able to protect against agency risk, and evaluate if a manager is doing a good job. • *Scope to generate excess returns likely to be much reduced* due to a combination of: - Limited access to better managers and risk of being courted by poorer managers less able to tap institutions - Less ability to access attractive assets directly at lower fees through direct or co-investment - Possibility that individual investors and some financial advice groups are tapped by managers looking for buyers of less attractive assets, i.e. offered dregs, not the cream - Higher fees and costs due to limited ability to negotiate and potentially additional costs charged by distributors • *Reliance on agents* such as financial advice groups and and/or consultants to identify and access good managers. - Greater risk that these agents could lack the capabilities and access to opportunities to be effective - Potential to be less well-aligned with the clients due to the existence of other incentives (e.g. capturing share of the management fee) - Lack of prudential regulatory oversight from APRA, which provides scope for poor agents to remain under the radar until harm is done

Implications for ASIC

ASIC has a key role to play in protecting individual investors in private markets, noting the increasing demand to invest in these markets and the likelihood that providers will seek to tap this demand. ASIC is clearly well-aware of these trends, and we welcome the scrutiny being given to the matter. Areas that ASIC might focus on include:

- Improving transparency (discussed in Section 6), so that individual investors are as fully informed as possible on the nature of their investments.
- Ensuring that agents who supply private market investments to individual investors are behaving appropriately and operating in their best interests, including disclosing any conflicts.
- Monitoring terms under which investors may access their capital, i.e. income and capital distributions, and any redemption terms (where they are provided).

- Keep a watch for development of secondary markets that are made available to individual investors, and that conditions within those markets are fair and reasonable.
- Considering what provisions might apply to pooled investments accessed by individual investors, including both retail and wholesale (and how far to differentiate between the two).
- Providing education, e.g. through Moneysmart.

6. Transparency as a central issue for private markets

We view transparency in private markets as a central input into quality investment decision making. The opaque nature of private markets heightens the risk of harm to investors. It can allow conflicts of interest to fester under the surface, and inhibits the capacity of investors to make informed decisions. This is particularly the case for individual investors, especially those personally investing on a direct basis but also potentially those using a financial adviser to the extent that adviser groups may have less influence over private market managers and are limited in their capacity to oversee investments (see Section 5). We are less concerned when investment occurs through large super funds (see Section 4), but even there an uplift in transparency may be helpful. Greater transparency also enhances the ability of regulators, researchers and media to monitor private market managers and hold them to account.

We are not operatives in private markets and hence do not offer any detailed recommendations on how transparency might be improved. We acknowledge that many government and regulatory reviews have explored the issue of transparency for different types of investor types, most recently Treasury's *Review of the regulatory framework for managed investment schemes* (2023). We also recognise that there are hurdles to improve transparency. Consistency in disclosures is difficult to attain across various investment vehicles including managed investment schemes, wholesale trusts and offshore vehicles. A related challenge is whether there should be differing transparency requirements across asset classes. For instance, does it make sense to require high transparency for certain private assets while having lower requirements in other complex and risky forms of investments (such as crypto)?

Our general reflection is that size enables investors to demand greater transparency, and sophistication enables investors to make greatest use of transparency. Through this dual lens, we consider super funds as well-placed to access and use information to make good quality investment decisions; wholesale investors may have mixed experiences (e.g. sophisticated investors with well-informed advisers may be well-placed, while others may not); while retail investors are likely to be less well-placed (although some financial advice groups may be able to assist them).

Below we list criteria that would support a better-informed market. (This list reflects on what we would personally like to know to invest with confidence).

Important to know to make a well-informed decision:

- Basis of fee determination, e.g. base fee, incentive fees and hurdle rates, clawback provisions, timing of fee payment and recognition, etc
- Any conflicts of interest, e.g. related parties that may supply services charged to the fund
- Any payments from managers to platforms, financial advisers and adviser groups
- Basis of valuations and estimation of returns
- Assumptions underpinning any expected return indications, e.g. managers should be quoting expected returns net of all fees and costs (not referring to running yields)
- Terms on which capital will be returned or may be accessed

Beneficial for making a better-informed decision:

- Performance sensitivities and scenarios, along with key assumptions
- Details on investments, including invested assets by managers (controversial, as managers are reluctant to disclose) and managers employed in the case of pooled funds (e.g. platform products)
- Investment process, including approach to currency hedging

A related issue is the appropriate level of transparency and disclosure by super funds with respect to their private market investments. This matter is partly covered by existing portfolio disclosure requirements applying to funds. Our tendency is to view additional disclosures by super funds as less crucial, and that regulators should be primarily focused on whether fund trustees are managing their private market investments effectively (see Section 4.2).

Implications for ASIC

ASIC might want to address transparency and disclosure as a core part of their deliberations following this consultation process. This is a difficult topic area as it would require consideration of investor-type. Nevertheless, any steps that can be taken to boost transparency should represent a meaningful advancement.

Appendix 1

ASIC's discussion questions and brief responses

Discussion question	Conexus Institute response
Developments in global capital markets and their significance for Australia	
1. What key impacts have global market developments had on Australian capital markets? What key impacts do you anticipate in the future? Please provide examples from your experience.	• Increasing integration of markets seems inevitable. • Super funds likely to increase overseas investments and presence (e.g. offices), raising international and currency exposure but providing greater diversification for members
2. Do you have any additional insights into the attraction of private markets as an issuer or an investor?	• Section 4 argues that super funds are a natural conduit through which individuals can access private markets, while direct investment by individual investors is more problematic.
3. In what ways are public and private markets likely to converge?	• We view public and private markets as complementary substitutes than markets that are likely to converge.
4. What developments in public or private markets require regulatory focus in Australia	Comments here relate to private markets only. Regulators may (continue) to place focus on the following: • Super fund valuation governance and development / maintenance of member equity frameworks • Super fund liquidity management • Structures through which private market (and any illiquid) assets are being offered to retail investors, including MIS and via retail platforms • Disclosure in private markets • Marketing integrity, e.g. selective use of performance data; referring to yields as if they amount to returns
Healthy public equity markets	
5. What would make public markets in Australia more attractive to entities seeking to raise capital or access liquidity for investors while maintaining appropriate investor protections?	No comment
6. Do you agree that a sustained decline in the number, size or sectoral spread of listed entities would negatively impact the Australian economy? If so, can you suggest ways to mitigate any adverse effects that may arise from such changes?	No comment
7. To what extent is any greater expectations of public companies, compared to private companies, the result of Australian regulatory settings or the product of public scrutiny and community expectations of these companies?	No comment

Discussion question	Conexus Institute response
Private market risks and market efficiency and confidence	
8. Are Australian regulatory settings and oversight fit for purpose to support efficient capital raising and confidence in private markets? If not, what could be improved?	• Improving transparency and disclosure in private markets could lead to more informed investors. See Section 6. • Otherwise, no detailed comments to offer.
9. Have we identified the key risks for investors from private markets? Which issues and risks should ASIC focus on as a priority? Please explain your views.	• ASIC appears to have identified the major risks • Low opacity, conflicts of interest and fair treatment are priority issues among those listed. Investors should be better protected if regulators, researchers and media are well informed and hence better positioned to provide scrutiny. Agency risk is also important, and steps should be taken to reduce it where possible.
10. What role do incentives play in risks, how are these managed in practice by private market participants and are regulatory settings and current practices appropriate?	• We agree that incentives are important, but have little detailed insight into industry practice. • Section 3 of this submission highlights some incentive effects stemming from the YFYS test relating to encouraging leverage and credit risk.
Retail investor participation in private markets	
11. What is the size of current and likely future exposures of retail investors to private markets?	No insights, but appears to be growing due to demand from individual investors and desire of providers to access another source of assets to manage
12. What additional benefits and risks arise from retail investor participation in private markets?	Investment in private markets by retail investors is problematic, especially relative to via super funds who can operate as professional investors and are fiduciaries with a duty to act in members best financial interests. *Benefits* • Diversification away from public markets • Inflation hedging (some assets only) • Possibly returns, perhaps related to high tolerance for illiquidity, albeit limited by high fees • Commitment (overreaction to market volatility not possible as funds are locked in) *Risks* • High information asymmetry relative to providers • High exposure to agency risk due to little transparency, high fees and limited access to attractive assets (i.e. retail investors more likely to be offered the dregs) • Illiquidity (unexpected liquidity needs hard to meet) • Diversification may be hard to achieve as not always provided through a single or a few funds
13. Do current financial services laws provide sufficient protections for retail investors investing in private assets (for example, general licensee obligations, design and distribution obligations, disclosure obligations, prohibitions against misleading or deceptive conduct, and superannuation trustee obligations)?	• Disclosure and hence transparency could be improved. Refer Section 6 for discussion. • While super fund trustee obligations seem adequately covered by laws and regulations, many funds could improve their management of member equity with respect to private market valuations • Consideration might be given to investigating how the 3-day access to assets within super might be adjusted to better accommodate private and other illiquid assets

Discussion question	Conexus Institute response
Transparency and monitoring of the financial system	
14. What additional transparency measures relating to any aspect of public or private markets would be desirable to support market integrity and better inform investors and/or regulators?	Refer discussion in Section 6.
15. In the absence of greater transparency, what other tools are available to support market integrity and the fair treatment of investors in private markets?	• Insertion of informed fiduciaries that oversee investment on behalf of investors and are operating solely in in the investor's interest. - Super funds play this role. - Address any conflicts for financial advisers and other distributors to the extent they receive share of asset-based fees, e.g. through managed accounts. (Dixon Advisory is a prime example). • Make manager ratings available to broader investing public (perhaps via limited government subscription) • Provide education, e.g. via Moneysmart

Appendix 2

Unpacking the risk of a liquidity stress scenario

Figure 6: Illustrative liquidity stress scenarios

Illiquid asset weight / hedge ratio	30% / 50%		40% / 75%	
Market downturn	Standard	Difficult	Standard	Difficult
Starting portfolio				
Liquid assets ($)	700	700	600	600
Illiquid assets ($)	300	300	400	400
TOTAL PORTFOLIO ($)	1000	1000	1000	1000
Illiquid asset weight	***30%***	***30%***	***40%***	***40%***
% weight in overseas assets	50%	50%	50%	50%
% overseas assets currency-hedged	50%	50%	75%	75%
Portfolio adjustments prior sales				
% decline in listed asset values	-15%	-35%	-15%	-35%
% decline in unlisted asset values	-5%	-20%	-5%	-20%
% rise in foreign currency vs. the A$	10%	20%	10%	20%
Adjusted portfolio value prior sales				
Liquid assets ($)	610	478	516	400
Illiquid assets ($)	292	252	385	328
TOTAL PORTFOLIO ($)	902	730	901	728
% change in portfolio value vs. opening	-10%	-27%	-10%	-27%
Illiquid asset weight	***32%***	***35%***	***43%***	***45%***
Cash to be raised				
Net outflows from members (% assets)	-5%	-10%	-5%	-10%
Cash to meet member outflows ($)	-45	-73	-45	-73
Margin calls on currency hedges ($)	-25	-50	-38	-75
LIQUID ASSETS TO BE SOLD ($)	-70	-123	-83	-148
% of total portfolio	-8%	-17%	-9%	-20%
% of liquid asset holdings	-11%	-26%	-16%	-37%
Closing portfolio				
Liquid assets ($)	540	355	434	252
Illiquid assets ($)	292	252	385	328
TOTAL PORTFOLIO ($)	832	607	819	580
Illiquid asset weight	***35%***	***42%***	***47%***	***57%***
Verdict	**Manageable**		**Traumatic**	