Consultation Paper

Re: Growth / Defensive Asset Categorisation Proposed Solution

Introduction

Growth / defensive (henceforth "G/D") exposure is entrenched in industry. It is used to form peer groups by research groups, it is commonly used by financial planners and is used by APRA in their Heatmap reporting.

Yet growth / defensive remains undefined and no standardised approach exists for measurement. This creates concerns around subjectivity and gaming, especially given the huge range of investments that now exist. This reduces confidence in performance assessment.

A diverse working group (a range of super funds alongside research houses) has worked hard on this project for over 12 months. This is a true working group solution and does not represent the recommendation of any individual or their firms. The working group explored well beyond the proposed solution in many directions to enable an informed decision to pull back (where appropriate) to the recommended solution. This enabled a thorough exploration and also the opportunity to better explain our reasoning.

A variety of resource materials including introductory and detailed papers, presentations, models and templates can be found at the G/D resources page at www.TheConexusInstitute.org.au .

Please review the materials and make a submission. Your feedback will inform the working group and impact the final proposal, which will then be shared with APRA.

Consultation

We strongly encourage industry to engage in the consultation process and make this a truly industry-developed solution. All submissions will be read, considered and may significantly impact the design of the final version. Bypassing this submission process will reduce your opportunity to contribute.

Unless otherwise indicated, all submissions will be treated as confidential and only shared amongst working group members.

The working group is focused on a framework which balances the following issues:

1. Desire to produce consistent, comparable fund exposure measurements across a large, diverse range of investment strategies
2. Concern around distorting investment decision-making
3. Operational impact.

Areas where we are unlikely to change:

- Replacing G/D with a risk metric – we have no mandate to change G/D. It is effectively embedded industry infrastructure. The aim is to provide a standardised, high quality approach.
- No diversification – for various reasons (relating to complexity and subjectivity) we are unlikely to incorporate portfolio diversification into fund G/D calculations.

You are welcome to comment on any topic in your submission. Areas of particular interest to the working group include (along with any suggested improvements):

- Consistency
  - Do you believe the approach treats different types of super funds comparably?
- Distorting investment decisions
  - Would the proposed approach distort how you construct portfolios (the scoring approach compared to your internal asset allocation approach)? Where is the distortion greatest? What changes would you suggest to reduce any distortion?
- Operational impact
  - Do you think the operational impact has been kept to a modest level given the option of adopting a conservative set of simple scores (subject to materiality)?
  - Where is the operational impact greatest?
- Appropriate trade-off
  - Do you think the working group has found an appropriate trade-off between the need to understand portfolio exposure, versus minimising the distortion of investment decisions and operational complexity?
- Detailed and simple approaches
  - Do you agree with the provision of a set of conservative simple scores which can be used to reduce operational impact?
  - Do you expect that your fund will use the simple approach, detailed approach or a blended approach?
- Materiality
  - A rule of thumb is that each 1% of exposure to more nuanced sectors (where detailed scoring provides greater insight) generates the potential for 0.25% understatement to a fund's growth score when simple scoring is applied. The table below identifies the potential impact:

Exposure to nuanced sectors	Potential understatement to growth score
5%	1.25%
10%	2.5%
15%	3.75%
20%	5%
25%	6.25%
30%	7.5%

  - What do you consider to be the appropriate trade-off between permitting the operational simplicity of simple scoring against the potential for growth score understatement?

- Unlisted property and unlisted infrastructure
  - Do you believe the process for categorising unlisted property and infrastructure assets as either Tier 1 or Tier 2 risk is effective and has reasonably modest operational impact?

- Risk scaling
  - Do you think the risk scaling approach is effective in scoring assets which do not naturally fit 100% G, 100% D?
  - Do you agree with the two approaches (volatility-based and drawdown-based) to better capture the nuances of different investment strategies?
  - The adjusted risk scaling approach has been specifically designed to incorporate high duration bonds. Do you think this approach is effective?

- Concerns around subjectivity and gaming
  - A degree of self-assessment is introduced through risk scaling and the categorisation of unlisted property and infrastructure. Given we are aiming for the information to be used by research houses and APRA (i.e. a single industry standard) and interrogated by these groups, thereby increasing governance standards, are your concerns around gaming modest or sizable?

- Any individual scores (as listed under “Scoring – Detailed”)
  - Are there any specific asset scores you would like to offer an opinion on?

Consultations need to be received by Monday 28 September. Please email consultations through to Submissions@theconexusinstitute.org.au

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