CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

T 1300 737 373
Outside Aust +613 9606 9677

cpaaustralia.com.au

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David Bell
Executive Director
Conexus Institute

Via email: submissions@theconexusinstitute.org.au

Dear David,

Growth/defensive asset categorisation

CPA Australia represents the diverse interests of more than 166,000 members working in over 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

This consultation considers the terms "growth" and "defensive" in relation to investment in asset classes. These terms have been used for decades throughout the financial services sector to illustrate core attributes of assets used for investment, and in times past were often also used as an illustration of investment risk.

Accurate descriptions of the attributes of assets available for investment are a necessity given the mandatory enrolment in Australia's $3 trillion superannuation system. We welcome the opportunity to provide clarity in relation to the use of these terms. However, we caution against a solution which renders these terms meaningless to superannuation fund members.

More details are contained in the attachment.

We acknowledge the valuable contribution to this submission by members of CPA Australia's Retirement Savings Centre of Excellence.

If you have any queries do not hesitate to contact Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at richard.webb@cpaaustralia.com.au .

Yours sincerely

Dr Gary Pflugrath CPA
Executive General Manager, Policy and Advocacy
CPA Australia

Attachment

Response to Consultation

Introduction

Our submission comes from the perspective of our members who advise retail and wholesale clients in relation to investment in assets which may be categorised as "growth" or defensive". We note that the Working Group which has been convened by the Conexus Institute is very well served by some distinguished names from superannuation fund trustees, fund managers and ratings agencies, however, the Working Group does not yet feature representatives from the area of financial advice. This may not necessarily be seen as a negative for the working group, as we note later in this submission that the terms may have strayed from their original usefulness to retail investors and superannuation fund members.

However, we note that there is an opportunity to clarify the use of these terms in a way that does not render them incomprehensible, or worse, misleading, to members of funds in Australia's $3 trillion superannuation sector.

CPA Australia's central question in this submission is essentially, for who is this work being undertaken? If it is for trustees and the investment professionals with whom they deal, then we believe that this is potentially a largely academic exercise where retail investors, such as members of superannuation funds, may be more or less irrelevant.

The matter of how to relevantly describe assets to investors is difficult: Product Disclosure Statements (PDS) are littered with funds management descriptions containing short statements which are intended to convey meaning to investors in relation to the investment options in their superannuation products. Often, these can read as sales pitches which shed little light on the actual approach of the investment managers. Some of these terms, particularly those relating to options for investing in listed equities, already use the term "growth" in relation to specific active investment selection techniques, which is unfortunate. When the term is then used to differentiate from "defensive" elsewhere in the same PDS, this may create confusion.

Ratings agencies would prefer a simple way to compare the investment options in superannuation funds, and may use the growth-defensive delineation to assist. While they may not necessarily intend for this to mean something in terms of investor risk to retail investors, there are many who will take the presentation of ratings agencies as an impartial view of the sector.

We also note that MySuper heatmaps released by the Australian Prudential Regulation Authority (APRA) provide benchmarked risk and return information utilising APRA's definition of "growth" and "defensive". While APRA has discouraged use of their heatmaps as a ranked system of league tables, there is no doubt that this is how some stakeholders are using them.

At various times in the past, financial advisers have used the terms "growth" and "defensive" for a variety of purposes when interacting with their clients, to help them understand their investment needs, for example:

- "Growth assets" may have been used to describe assets which were primarily invested in to provide potential capital growth, and
- "Defensive assets" may have been used to describe assets which broadly held their capital value and were invested in for access to reliable income streams.

Clients' investment needs, when taking account of these attributes, were often considered to be separate from their investment preferences in relation to risk, return and time horizons.

Gradually over time, these terms became attached to a number of traditional asset classes, rightly or wrongly, with shares and property being assigned to the category of growth and cash and fixed interest being assigned to the category of defensive.

This categorisation presents issues with the growing pool of potential asset types in which superannuation funds (and other readily available investment vehicles) can invest, including infrastructure, hedge funds, commodities and derivatives. While we would agree that an approach where there is a spectrum between growth at one end and defensive at the other may assist in determining where such assets can be classified, we have significant doubts that this serves a purpose for retail superannuation investors.

We applaud the work that the working group has done in compiling the consultation material, which is thorough and very informative. We do not plan to address the consultation questions in this submission, but overall we agree with the focus of the working group on the provision of a framework addressing the issues of consistency and comparability, potential for distortion of investment decision-making, and operational impact.

However, we believe that a very valid consideration must be on the perceptions of how retail investors invest their retirement savings, when they see such terms in use. Our comments follow.

General comments

We agree with the approach whereby the growth-defensive rating is not to be treated as a risk metric, but rather as an "exposure metric". Feedback from CPA Australia members who provide financial advice suggests that they do not use these terms to understand the risk or return preferences of their clients.

We raise the question: what is an "exposure metric"? The Detailed Paper discusses this term as an indication that there may be downside risk to investment in certain assets. For some investors, the likelihood of downside risk is something they would very much consider in terms of their risk exposure, and would value information which conveys this. However, we wonder whether the Standard Risk Measure presently in use already serves this purpose. It rates the short-term risk of investment in superannuation fund investment options, and uses a scale of expected number of negative years' returns over a 20 year period. It may even be of better use to investors to rate specific investment in asset classes by a trustee using this tool, as the risk rating may take into account, not only the asset class, but also the style of the underlying investment managers.

We note that development of a longer-term risk measure may provide some additional context around investment risk, as the Standard Risk Measure is used to rate short-term risk. However, in isolation this measure does not consider how a superannuation investment option may perform against longer term risks such as inflation.

In addition, we have some concerns that the terms "growth" and "defensive" remain undefined. The Detailed Paper explains that the Working Group feels that any formal definition would be contrived, and the process which has been arrived at appears to be one aimed at formulating uniformity in this process. It seems that this is a missed opportunity to provide clarity to members of superannuation funds and other retail investors, and may not resolve concerns that the terms could be perceived as arbitrary.

To explain the issue of definitions further, we look at a number of examples from Table 2 in the Detailed Paper. Equities are scored under both the Simple and Detailed methods as 100% growth, whereas cash (and cash-enhanced) are scored as 100% defensive. Other assets occupy a space in between, for example, unlisted infrastructure is classified as 80% growth under the Simple method, or 60:40 growth to defensive (Tier 1 risk) and 100% growth (Tier 2 risk) under the Detailed method. Given how the terms have been used in the past by financial advisers with their clients (see earlier in this submission for an example), this could present some interesting anomalous outcomes.

For example, consultation with CPA Australia members reveals that certain investment vehicles exist for superannuation fund members with significant movement in terms of tactical asset allocation, relative to the fund's long-term strategic asset allocation. In one case, exposure had been tilted in the direction of fixed interest due to a perception that the market had not appropriately priced in a likely cut to interest rates. Given that fixed interest appears to mostly be classified as 100% defensive, is this still a realistic assessment given the tactical intent of part of the fixed interest exposure?

Another example relates to the treatment of short-selling. A number of funds use short-selling in addition to enhanced long positions and do not consider that they are hedge funds. How do these fit into the framework? We note some commentary in relation to this in the Detailed Paper, but given that these positions are often undertaken by fund managers to limit downside risk, are they still to be considered 100% growth?

Given the reliance of APRA on the allocation to growth assets when setting out its MySuper heatmap data, how this term is defined is of considerable concern. This is likely to present further areas of confusion when APRA extends its heatmaps to choice investment options.

Defining the terms growth and defensive may have a number of advantages:

- The terms could be adapted in a more specialised way to individual assets or investment pools to better reflect the purpose by which the investment manager is using the assets.
- Assets which change categorisation could be better monitored by regulators and researchers.
- Appropriate descriptions of asset attributes would assist financial advisers when assessing their clients' attitudes and investment preferences.

It is the last point above which we believe is most important. If it is the intention that these terms are to be used specifically by trustees in dealing with investment professionals, then what is the benefit of these terms in funds' member-facing promotional and other literature? What is the benefit of APRA categorising MySuper investment data by allocation to a nebulous idea of a "growth asset", when perhaps a better understood categorisation may exist through use of the Standard Risk Measure in conjunction with a yet to be developed long-term measure of risk.

CPA Australia recommends that if the terms are not to be defined, then their use is not appropriate for retail investors, and as such, their use should be discontinued by both funds and APRA.