Biennial Convention 2009

Go for Gold

19–22 April 2009 • Sydney

Institute of Actuaries of Australia

Accumulation Funds Managing Liquidity Risk in a volatile world

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Agenda

- What is liquidity risk for a super fund?
- Fund-specific factors affecting liquidity
- External factors affecting liquidity
- Legislative & APRA requirements
- Liquidity Risk Management process
- Discussion
  - Capital?
  - New roles for actuaries?

What is liquidity risk for a super fund?

- Risk that cannot meet:
  - – benefit & pension payments
  - – rollover requests
  - – requests to switch investment options
  - – 3^{rd} party payments (insurance, tax, admin fees)

at all, or without significant cost

Fund-specific factors affecting liquidity

1. Cash flow
2. Investments
3. Fund design
4. Member demography
5. Member behaviour

1. Cash Flow

Retail Wealth Management Co.

INFLOWS

- Industry Fund and Corporate Fund: Mainly mandated SG contributions; Some discretionary contributions & rollovers
- Retail Super Fund and WRAP Platform: Some mandated SG contributions; Mainly discretionary contributions & rollovers
- Corporate Master Trust: Same as Corporate Fund
- Retirement: Discretionary rollovers

Funds

- Industry Fund (mostly super, some retirement)
- Corporate Fund (super & retirement)
- Retail Super Fund
- WRAP Platform (super & retirement)
- Corporate Master Trust
- Retirement

OUTFLOWS

- Industry Fund and Corporate Fund: Small rollovers to other funds; Small pensions in payment
- Retail Super Fund: Rollovers to other funds
- WRAP Platform: Pension payments; Small rollovers to other funds
- Corporate Master Trust: Transfers by employer to another fund; Small individual rollovers
- Retirement: Large Pension payments; Small rollovers to other funds

NET FLOWS

- Industry Fund: **Strong net inflow in all markets**
- Corporate Fund: **Generally in net inflow**
- Retail Super Fund and WRAP Platform: **All inflows & outflows discretionary. Can change quickly from net inflow to net outflow**
- Corporate Master Trust: **Generally in net inflow but can change to outflow eg. if a large employer leaves**
- Retirement: **Can be in net inflow or outflow depending on rollovers**

INVESTMENTS

- Industry Fund and Corporate Fund: **Generally hold some unlisted investments**
- Retail Super Fund, WRAP Platform, Corporate Master Trust and Retirement: **Generally hold all listed investments**

2. Investments

- Increasing use of unlisted assets:
  - direct property
  - hedge funds
  - private equity
  - infrastructure
- Currency hedging
  - large pay-outs by some funds
- Strategic asset allocations control actions

3. Fund design

- Choice of investments
  - – number of investment options
  - – ease of switching (internet, phone, email)
- Less $ in the “main” Balanced option
  - – and money can move quickly
- Product innovation in pension space
  - – eg. keep $ in Balanced but risk “insurance” overlays

4. Member demography

- age profile
- typical retirement age
- likely retrenchments (corporate funds)
- deaths and disabilities
- …. affect how likely members are to:
  - have their balance paid out of fund
  - retire and either start a pension or take balance out
  - take higher than usual pension payments

5. Member behaviour

- financial literacy
- access to financial advice
- ….affect how likely members are to:
  - – switch investments
  - – choose another fund and roll out
  - – take your fund with them from job to job

External factors affecting liquidity

1. Global Financial Crisis
2. Other factors
   - Portability
   - Award modernisation
   - Temporary resident payments

1. Global Financial Crisis

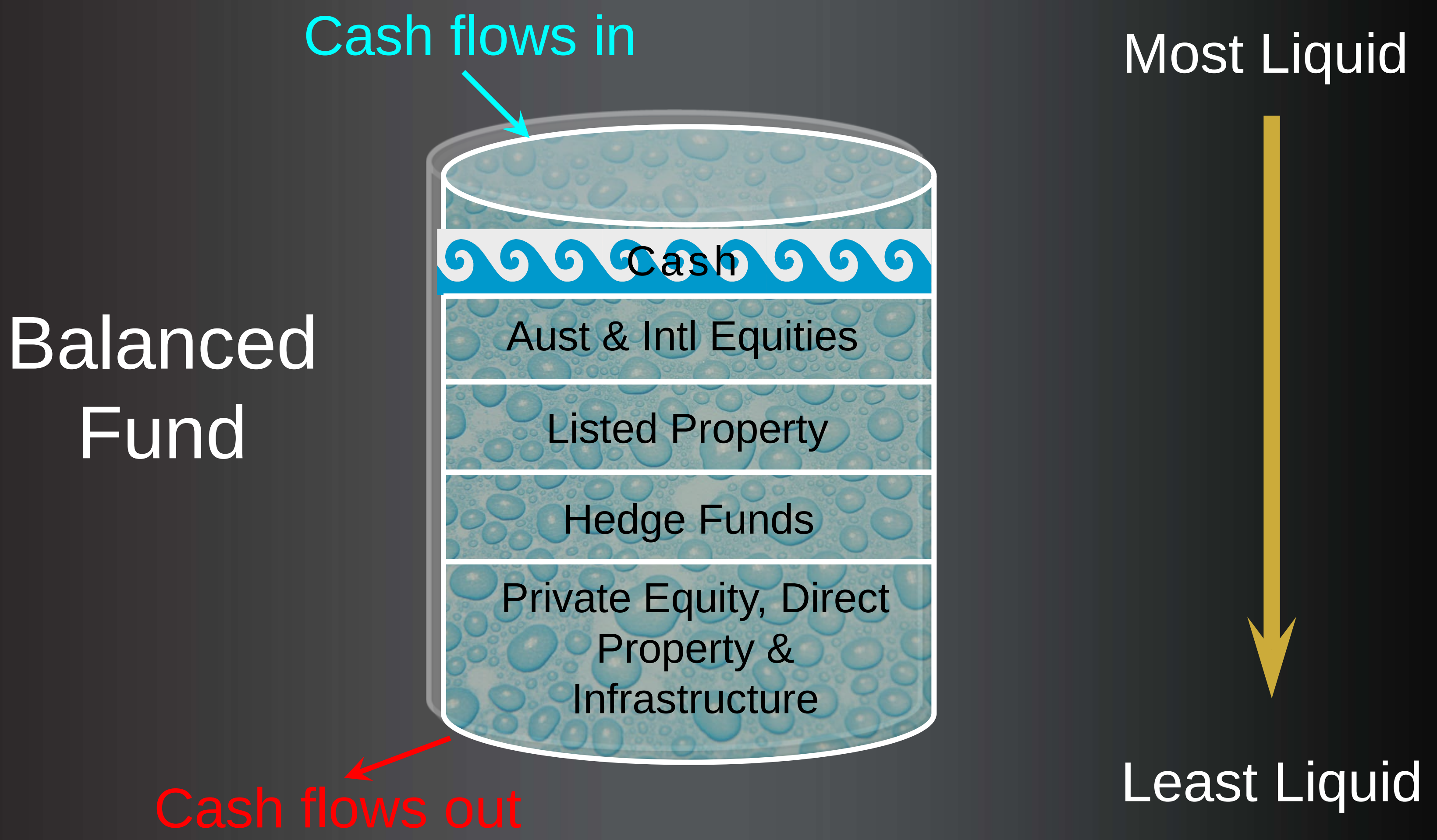
- Increased market volatility
- Declining returns
- Current illiquidity of all almost all asset classes
- Freezes on redemptions by some fund managers

1. Global Financial Crisis

Changes to behavior:

1. Switch to cash
   – Less than expected across industry – high in some funds
2. Stopped or lower discretionary contributions
   – Dec ’08 discretionary member contributions down 50%* on year earlier (APRA Qtrly Perf. Dec08 Table 1b)

When the liquidity tide goes out…

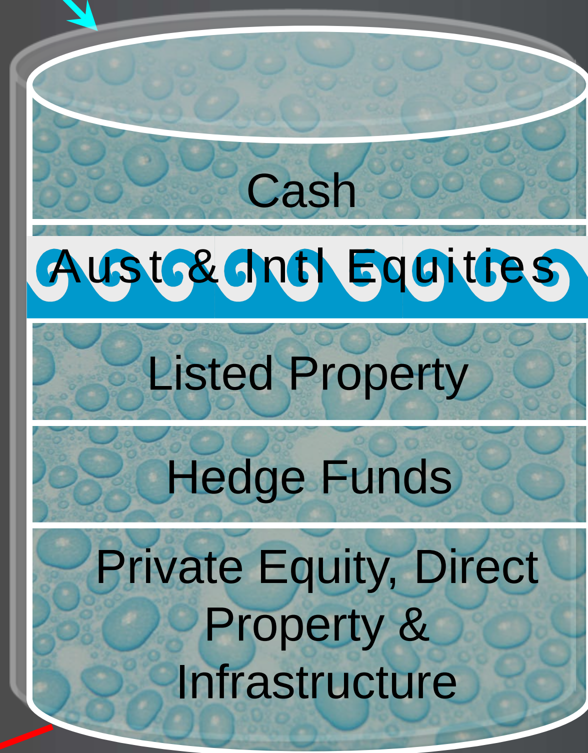


When the liquidity tide goes out…

Cash flows in

Most Liquid

Balanced Fund



Least Liquid

Cash flows out

2. Other factors

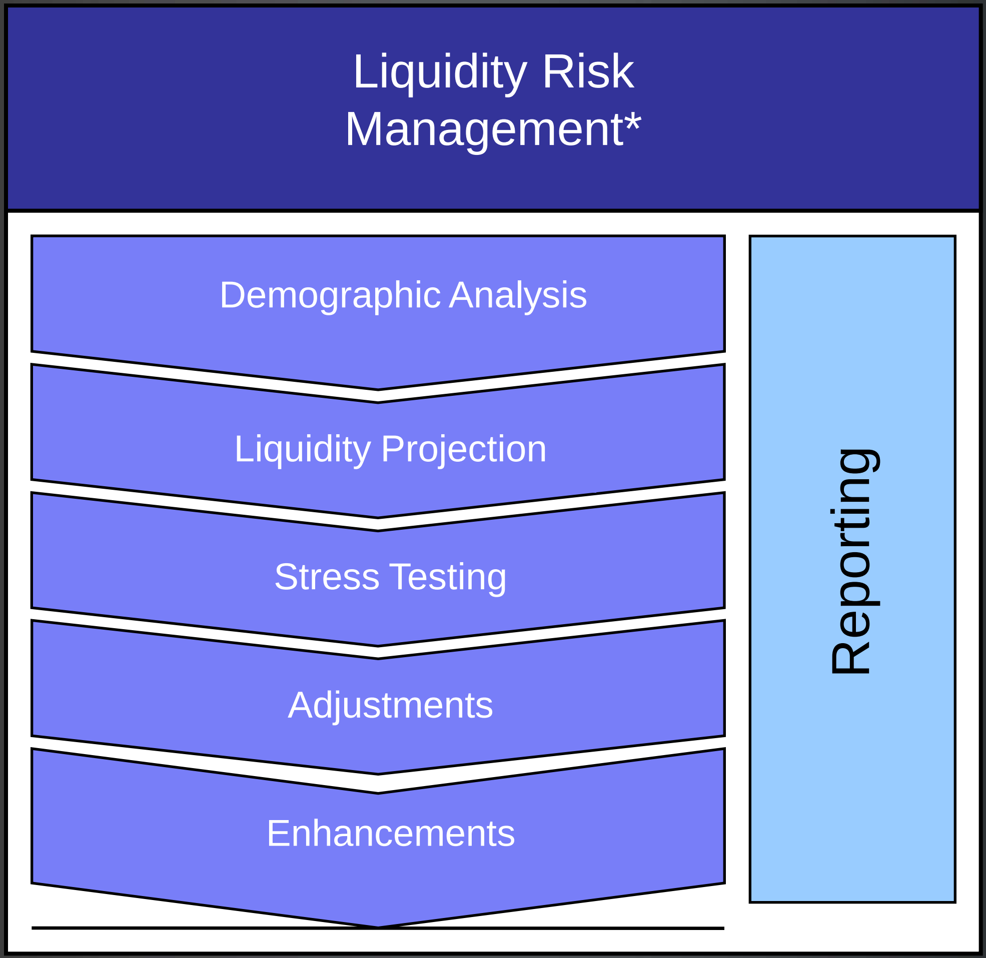
- Increased portability
  - e-enabled super industry: quick and easy to rollover
- Award modernisation
  - over time will “turn off the tap” for some funds
- Temporary residents payments 15 June 2009
  - estimated $800 million

Legislative requirements

- When formulating investment strategy, trustees must consider liquidity risk
  - Section 52 SIS Act
- Risk management plan must include all material risks including liquidity risk
  - Section 29P(2) SIS Act

APRA’s expectations for trustees

- understand fund’s liquidity requirements
- ongoing liquidity management measures
- analysis & scenario modelling
- adequate liquidity within investment options
- consideration of future required contributions to infrastructure etc.
- monitoring inflows & outflows across investment options day to day & L-T
- contingency planning for S-T liquidity mismatches
- internal & external auditor oversight of liquidity risk



* “Managing your superannuation fund’s liquidity risk”, KPMG Superannuation Services, 2008

Discussion: Capital?

- Funds have limited ability to build up cash outside Strategic Asset Allocation ranges
  - Change SAA?
- Should funds hold capital?
  - can provide liquidity
  - can cover additional costs when liquidity issues arise (significant event disclosure, additional communication and marketing)
- Capital is expensive –cheaper to insure?

Discussion: New roles for actuaries?

- Sign off on funds' liquidity risk management plans
- Sign off on methodology for valuing unlisted assets?
  - – no uniform methodology
  - – valuing uncertain future cash flows
  - – only auditors currently sign off

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