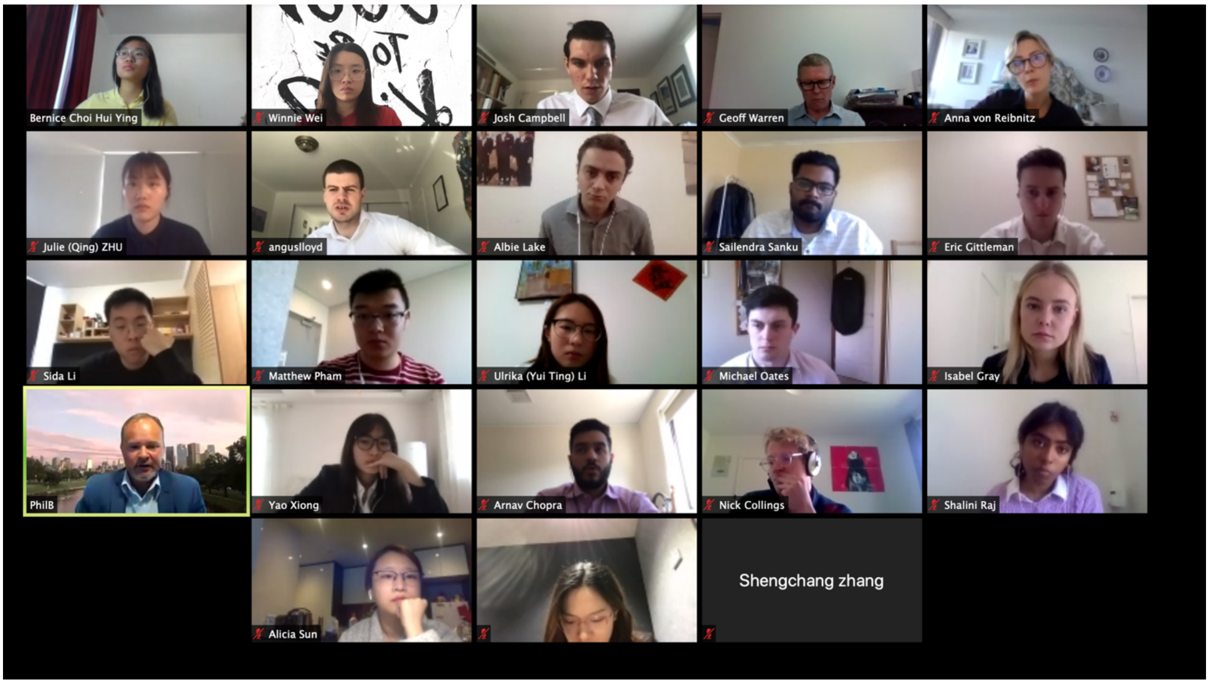
Guest Speaker Spotlight: Phil Brown



The SMF was pleased to welcome Phil Brown, the Executive Manager of Investments at MTAA Super, as a guest speaker on 10 August 2020. Phil shared his insights into the superannuation industry and provided an overview of the MTAA Super Investment Program. His team manages a A$12.4 billion diversified portfolio containing both public and private market assets. It also provides support to the Investment Committee which is responsible for MTAA's investments. Phil has had a long career in management positions, including as a Prudential Supervisor with the Private Health Insurance Administration Council (PHIAC) and Assistant Manager of Medibank Private Limited's investment portfolio.

Some of the key insights that Phil shared with the SMF are summarised below, as well as the Q&A session that followed.

MTAA Related

Governance Structure

Phil described how MTAA Super operates within the regulatory and tax framework that is overseen by the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investment Commission (ASIC) and the Australian Taxation Office (ATO). MTAA has its own Investment Governance Framework that comprises policies such as the Investment Policy Statement, ESG Policy and Liquidity Policy. These policies assist MTAA to both meet regulatory standards and ensure the sound delivery of outcomes to fund members.

MTAA use an out-sourced model, where the fund is managed by a small in-house investment team of six professionals who collaborate closely with external consultants to prepare investment recommendations; while outside managers directly invest the assets. The team aims to leverage on the investment advice provided by consultants on investments and managers to take to the Investment Committee, which is ultimately responsible for the portfolio and managing investment risk.

Investment Philosophy

MTAA's primary investment purpose is to deliver long term returns and enable fund members to improve their financial security in retirement. Their objective is to deliver these returns in a sustainable and stable manner with low frequency of negative annual returns. This philosophy is supported by a Statement of Investment Beliefs, which encompasses their governance structure, investment objectives, investment strategy and implementation practices.

Product Offering

MTAA offers a breadth of products to tailor its service to best meet the needs of its customers. There are eight options for members. These include four pre-mixed diversified options called 'Balanced', 'Conservative', 'Income-focused' and 'Growth', and four options for the specific asset classes of cash, fixed income, Australian shares and international shares. Members are free to move between the options with short notice to maximise flexibility.

MTAA's flagship offering is the balanced option, named '*My AutoSuper*'. This fund outperformed the CPI by 3.5% over a 7-year period. Its three primary asset classes of International equities, Australian equities and infrastructure constitute approximately 60% of the portfolio.

Investment Performance

To ensure strong returns and maintain its competitive edge, MTAA assesses the performance of both the fund and its managers using a mix of key performance indicators. Fund performance is measured in terms of total returns, peer-related returns, risk-adjusted returns and the specific benchmark or objective for the option. Managers are measured relative to their market index and expected performance benchmarks, while accounting for extraneous factors such as how value stocks have performed versus growth stocks. They are also assessed on business-related operational issues such as compliance breaches, strategy drift and key personnel turnover.

Early Release from Super

COVID-19 has brought about a fundamental change in the Australian superannuation system in allowing members to withdraw $20,000 from their super to assist with short-term obligations. Such a policy had never been attempted, which has made it particularly difficult to forecast. The policy has created a major liquidity management issue, especially for funds with higher allocations to illiquid, unlisted assets during the time when equities took a large hit. Worst hit are specific industry super funds that had high employee layoffs, such as those in the hospitality and retail industries. MTAA has already paid out over $500 million and has significantly increased the frequency of its liquidity assessments.

Environmental, Social and Governance (ESG)

MTAA has made tremendous strides in the ESG space to differentiate itself as cognisant of these risks. They have adopted the United Nations Principles for Responsible Investing, appointed dedicated ESG officers, are a member of the Climate Action 100+ Initiative and have rebuilt their own ESG framework. While efforts to improve ESG practices are a constant work in progress, MTAA's actions ensure they are operating under the appropriate principles and working towards the goals that their members expect.

Unlisted Assets

Although constituting a smaller portion of the asset allocation as compared to Australian and International equities, unlisted assets such as infrastructure, property, private equity and multi-asset securities are still a vital part of MTAA's portfolio and increase portfolio diversification. They also hold real return funds, which are multi-asset funds investing in a range of asset classes that are often listed. These funds serve as a liquid alternative that assists with liquidity management. They proved useful in meeting the early release from super, allowing MTAA to meet its short-term obligations by redeeming some of these investments without having to sell equities and forego the profits made from the subsequent upswing in the market.

Key Insights

Phil's three main takeaways from his years of experience are:

- Liquidity is everything.
- Scenario and sensitivity analysis are critical.
- Currency hedging needs to be managed carefully.

While funds relying on member contributions for their liquidity might be fine in prosperous times, they could be at risk during unprecedented times – such as during the COVID-19 pandemic. As contributions decrease rapidly and withdrawals are made, funds can face significant liquidity issues.

Scenario and sensitivity analysis serve as a valuable compliment to other valuation techniques. However, they do not always predict extraordinary events such as the pandemic and the early release from super.

Currency hedging can help mitigate currency risks. However, it also brings about other risks such as cash flow management. (Note: A fall in the A$ requires cash to settle the losses on hedging contracts, even though the lower A$ also boosts the value of the overseas assets.) Further complicating matters is the notorious volatility of the A$, which often drops when markets correct. As such, it is imperative for investors to manage these trade-offs appropriately, rather than envisage currency hedging as an insurance policy.

Q&A

1. **Is there a trend of reduced contributions to super, and how does that risk materialise given an aging population and early release from super?**

Australia's policy of compulsory super has supported the aging population and reduced the burden on the Age Pension. Although most members contribute an appropriate percentage of their income, the early release will pose a long-term threat to those who do withdraw. While some Australians who withdraw are struggling in these unprecedented times, others are taking early release to support purchases they would not usually make. This can be tied back to the poor engagement and understanding of super by many Australians. Many do not see super as their money since they do not receive cash in hand. Given the average total contribution per member is not high enough to support retirement and the average member age in MTAA Super is currently 42, early release will definitely increase the burden on the Age Pension. MTAA has committed to ongoing efforts to advise and educate its members around super, increase engagement and reduce this burden.

2. **Although Australia is in the midst of a pandemic with many forecasting a recession, we've seen record high PE's. This would often lead to a defensive approach. How can a risk averse fund take a defensive approach in poor economic conditions without greatly sacrificing returns?**

MTAA considers there to be risk to the downside, and so has allocated a smaller amount to equities as compared to peers. When markets plunged earlier this year, that strategy paid off. As central banks have supported the markets, MTAA has increased its equity exposure in line with peers to capture the profits associated with the recent recovery. While MTAA does not tend to tactically adjust our asset allocation, we have introduced long put options to manage exposure to downside risk.

3. Do you have any comments on sector performance over the next 2-3 years?

The technology stocks will continue to enjoy high growth, but an investor must be selective. The sector proliferates with each new idea; however, many stocks quickly disappear as the winners emerge. The financial services industry will experience challenges in upcoming years from the pressures associated with the Royal Commission into financial services.

4. Is there a trend of consolidation in the superannuation industry?

Yes. All superfunds face the challenge of achieving competitive returns and providing effective services without charging uncompetitive administrative fees. While the scale test has now been replaced by a member outcomes test, many funds are merging to avoid issues associated with this test. APRA also uses this test to encourage trustees to consider mergers. Although MTAA presently scores well on the member outcomes metrics, we nevertheless have an impending merger with Tasplan that is driven by a desire to future proof ourselves and improve scale and investment returns for our members.

5. Since multi-asset investments have proved beneficial in light of the early release payments, what is the future role of this investment for MTAA?

As making investments in unlisted infrastructure and property is opportunistic and may take time, multi-asset funds have filled the gap by helping to maintain a high aggregate exposure to alternative investments. They also proved particularly beneficial this year in funding the early release scheme, and positioning MTAA to enjoy the profits from the recovery in listed equities. The MTAA investment team believe multi-asset funds are a strong and useful investment, and so aim to increase the target allocation and make them a permanent fixture of the MTAA portfolio.

Recorded by Arnav Chopra (Relationship Officer)