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Sent by email

Re: Consultation for Your Future, Your Super package

Palisade Investment Partners Limited (**Palisade**) is pleased to provide this submission as part of the public consultation process relating to the Exposure Draft released on 28 April 2021 regarding the Your Future, Your Super (**YFYS**) reform package. Specifically, this submission relates to the proposed benchmark to be used for Unlisted Infrastructure as part of the annual performance test for MySuper products.

In December 2020, Palisade provided a submission as part of the first YFYS consultation. In this submission, Palisade highlighted its concerns regarding the benchmarking of unlisted infrastructure investments to a global listed benchmark, and the potential for this to discourage Australian superannuation funds from continuing to invest in unlisted infrastructure. We acknowledge the Treasury's thorough consultation process as part of the first Exposure Draft, and note the move away from the listed FTSE Developed Core Infrastructure Index to the unlisted MSCI Australia Quarterly Private Infrastructure Index (the **MSCI Index**) for benchmarking purposes.

Ultimately however, whilst Palisade is supportive of Treasury's decision to not utilise the FTSE Developed Core Infrastructure Index, we do not believe the MSCI Index is an appropriate index to benchmark the performance of unlisted infrastructure.

MSCI Australia Quarterly Private Infrastructure Index

Palisade has been a contributor to the MSCI Index since 2012, with both Palisade's Diversified Infrastructure Fund and Palisade's Australian Social Infrastructure Fund comprising approximately 3.5% of the index value as at 31 March 2021.

Based on our long-standing contribution to the MSCI Index, there are a number of factors which, in our view, make it inappropriate to use as the benchmark for Unlisted Infrastructure for the purposes of the YFYS annual performance test. These include:

- **Lack of diversification** – In its infancy, the majority of investing activity within the infrastructure asset class (and consequently portfolios) was dominated by transport assets such as airports, ports and toll roads, and regulated assets such as electricity and gas transmission and distribution networks. As the infrastructure asset class has evolved, and increasingly become part of mainstream portfolios, so too has the varied risk profiles that the asset class provides by virtue of its (sometimes very different) sub-sectors. Sectors such as waste management, the broader energy value chain (e.g. generation, efficiency and storage) and more recently communications infrastructure, have become key contributors to infrastructure portfolios, bringing with them an ever-increasing spectrum of risk profiles within the one asset class. As a consequence of this, 'typical' infrastructure portfolios can vary markedly between investors, depending on the specific investment objectives of the investor. Investment objectives vary among superannuation funds depending on factors such as member demographic and liquidity requirements.

With respect to the MSCI Index, we note that as at 31 March 2021, only six managers contributed to the index. This limited data set could result in the risk profile of the index being very different to the 'available' risk profile that investors could theoretically expect by undertaking a passive investment strategy. Further exacerbating this issue is the fact that the MSCI Index is 'value weighted', with one manager appearing to comprise up to 60% of the index value. The investment strategy of this manager, and particularly the risk profile of certain investments within that manager's pooled fund, will likely be a key determinant of the overall risk profile of the index. Related to this, Palisade notes that as at 31 March 2021, almost 75% of the MSCI Index was comprised of 'Transport' or 'Economic / GDP-linked' assets. Given these assets have inherently greater levels of growth than 'Regulated or Contracted' assets, this may significantly disadvantage those superannuation investors who have opted for more yield-based infrastructure portfolios offering greater downside protection. We do not believe it is appropriate that superannuation funds which, in the past have managed their infrastructure portfolios within a certain risk tolerance for the betterment of their members, are now faced with the prospect of being deemed an underperforming fund due to their historic deliberate investment strategy. This may cause some superannuation funds to introduce added risk to their portfolios in the pursuit of absolute returns, undoubtedly an unintended consequence of the new reforms. In any event, infrastructure portfolios can take years to develop given the opportunistic nature of the asset class in terms of sourcing new investments, and a change in risk profile for an infrastructure portfolio may take an equal amount of time to implement given the potential recycling of lower risk assets into higher risk assets.

- **Consistency of constituents** – Palisade has been a long-standing contributor to the MSCI Index, noting however that the provision of returns data by infrastructure investment managers to MSCI is entirely optional. In March 2020 Palisade observed that the index value fell by approximately 70%. Whilst a small proportion of this decline was due to the impact of COVID-19 (the 3 month return for the MSCI Index to 31 March 2020 was -7.0%), the vast majority seemed to be due to the largest constituent of the index not reporting for that period. Given the relatively small number of constituents, the fact that fund managers can voluntarily report or not report their results may cause added volatility to the index which is not related to the actual performance of the asset class. Additionally, given this optionality, there will, we believe, be biases towards the upside given that funds that are performing well would be more likely to report their performance than those that are not.

- **Timeliness and availability** – Whilst high level information on the MSCI Index is available directly from MSCI free of charge, an annual subscription is required to access the full index. We do not believe it is appropriate that superannuation fund members should bear the costs of accessing the index for the purposes of the YFYS annual performance testing. Palisade also notes that given the index is reliant on infrastructure managers providing returns data, this may result in the index not being available in time for when the performance test needs to occur. We note the Exposure Draft stated that the listed infrastructure benchmark could be used as a substitute in these circumstances, however Palisade's view is that this only increases the potential volatility of what we consider to already be an inappropriate index.

Palisade has been investing in Australian unlisted infrastructure for over a decade, with a 10-year gross return for our flagship infrastructure fund, Palisade's Diversified Infrastructure Fund, of 12.5% per annum to 31 March 2021. Whilst there have been attempts over a number of years to create a suitable benchmark for the unlisted infrastructure sector, the measurement of performance relative to a 'passive' benchmark has always been a challenge for both fund managers and investors given the non-observable nature of valuations and returns. This issue is compounded by the varied risk profiles of infrastructure sub-sectors, and the specific investment objectives for investors with respect to desired outcomes from investing in the asset class.

Palisade does however recognise the need for a benchmark, and remains fully supportive of a performance reporting regime to ensure best outcomes for the superannuation industry. To that end, following a number of discussions with industry participants, Palisade believes that the most appropriate benchmark for the purposes of annual performance testing of unlisted infrastructure would be one equal to the Consumer Price Index (**CPI**) or Australian Government Bond yield plus a fixed margin. Particularly in the case of CPI, given the strong inflation linkages inherent within the asset class, we believe a CPI benchmark provides strong alignment with factors investors are typically seeking from the asset class. Furthermore, CPI benchmarks are already widely used by superannuation funds in terms of benchmarking the performance of different member options.

Palisade would welcome the opportunity to discuss further.

Yours faithfully,

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