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LIQUIDITY ISSUES HIT SUPERANNUATION FUNDS

Current financial market conditions have created serious liquidity issues for superannuation funds with some forced to sell assets at deflated prices to fund ongoing cash requirements. A research paper by QIC's Capital Markets identifies factors contributing to liquidity issues for superannuation funds and outlines strategies to more effectively manage liquidity and illiquidity risks.

QIC Managing Director, Capital Markets Troy Rieck said recent market events had illustrated the potential effects for funds not adequately planning for liquidity and risk management issues.

"Funds are facing increasing liquidity issues caused by a range of factors including increased member movement into defensive investment strategy options and the need for funds to maintain hedging positions," Mr Rieck said.

"The volatility of equity markets has seen members move from default growth investment options to more defensive investment options. These member switches require the availability of cash, posing liquidity issues in times of extreme market movements.

"Unlisted assets, such as infrastructure, also impact on liquidity. Not only are they illiquid by nature, but irregular asset valuation models have the potential to impact on a fund's position. Many alternative assets require an initial investment and a commitment to make further investments ("calls"). These calls may cause issues for superannuation funds if they occur in times of market illiquidity."

"A flow on effect is that funds may be forced to sell liquid securities, especially listed equities, to boost cash levels in a buyers' market – potentially at a discounted price," he said.

The good news is there are immediate and longer term strategies a fund can implement to manage liquidity risk.

"An important step in is conducting comprehensive scenario planning on the impacts of member switching, currency movements, margin calls, capital calls and other liquidity requirements," Mr Rieck said.

"We have undertaken this analysis for our clients for a number of years and it has really helped during this crisis. Incorporating this type of holistic risk management into their investment processes should be a 'must have' for super funds."

"A fund should also implement a frequent rebalancing program, in order to protect themselves from the risk of markets becoming highly illiquid around month end trading dates. This also allows funds to benefit from equity and bond market volatility, as they tend to be buying when markets are falling and selling as they rise."

"Derivatives should also be investigated as an effective way of managing desired market exposures while retaining flexibility to provide liquidity as required," he said. "The flipside of acquiring this capability is an enormous positive for the fund, allowing it to proactively and efficiently manage its asset allocation, and to select from a far greater range of implementation techniques for each class of exposure."

Many of QIC's clients already enjoy these benefits.

The QIC 'Red Paper' – *Liquidity in superannuation funds* can be downloaded in full from the Knowledge Centre of QIC's website - www.qic.com.

QIC is one of Australia's largest institutional fund managers with \$70 billion¹ under management for its Australian and overseas clients.

¹ As at 31 October 2008

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