Confidential

National Australia Bank Ltd
Level 28, 395 Bourke Street
Melbourne VIC 3000
30 April 2025

Australian Securities & Investments Commission
Level 7, 120 Collins Street
Melbourne VIC 3000
By email to: markets.consultation@asic.gov.au

Dear Sir/Madam

Australia's evolving capital markets: A discussion paper on the dynamics between public and private markets

National Australia Bank Limited ('NAB', 'we', 'us', 'our') welcomes the opportunity to respond to "Australia's Evolving Capital Markets: A discussion paper on the dynamics between public and private markets – February 2025 ("ASIC Discussion Paper"). Reference is made to the ASIC Discussion Paper and recent conversations between ASIC and NAB Executives on this topic.

NAB has provided details to support our response, but note further review, investigation and consideration will follow, as key themes and areas of priority emerge. NAB notes that Private Wealth is not referred to in the ASIC Discussion Paper and have not included potential impacts to our Private Wealth clients. However, NAB would recommend that Private Wealth is also considered in the overall response.

A strong and prosperous Australian economy is dependent upon strong and effective Australian financial markets and access to global capital. In providing these responses, we have been conscious of the importance of ensuring Australia's financial markets, in all its nuances, remain strong, competitive, effective, robust, transparent, and instil confidence for issuers, investors, and consumers alike. An important aspect is ensuring appropriate governance and oversight by regulators and monitoring and reporting by participants.

Set out in the **Appendix** is our response to your discussion paper. NAB would welcome the opportunity to discuss our responses with ASIC and more generally the implications arising for Australia's financial markets and the economy.

We also refer to the email between [redacted] and [redacted] of NAB in relation to the response where it was agreed that NAB could provide the response on 30 April 2025.

[redacted]

Thank you again for providing the opportunity to participate in this important consultation. Should you require any clarification or further detail on our responses, please contact [redacted].

Sincerely,

[redacted]

[redacted]

Group Executive Corporate and Institutional, National Australia Bank

Appendix

1. Are the changes in Australia's public and private markets due to structural or cyclical shifts (or both)?

The changes in public and private markets are influenced largely by structural shifts, albeit cyclical shifts play a noteworthy role. Understanding these shifts requires a comprehensive analysis of both elements. Structural changes, such as the growth of domestic and global pension funds and the evolution of Private Capital firms, have significantly reshaped the market landscape. Concurrently, cyclical factors, including fluctuations in interest rates driven by economic monetary policies, play a crucial role in determining market dynamics at any given time.

The impact on private markets: A marketplace driven by structural change

Defining our terms

'Private Markets' is a broad term that captures several sub-sectors. The definition can cover the better-known asset classes of infrastructure and real estate, as well as venture capital, securitisation and mid-market direct lending (among others). For the purposes of our response, we have taken a broad approach, aiming to capture aspects of these lesser considered asset classes.

It is worth noting that these sub-sectors behave differently. As a result, cyclical changes such as an increase in interest rates due to economic/monetary policy may make one subset of Private Markets more attractive than another at a given time.

The structural shifts underpinning a changing landscape

In recent years, structural shifts have transformed private markets, reshaping the landscape in ways that have implications for banks, investors, companies, and the broader economy. The changes encompass a range of developments. We believe the following are key structural shifts that have influenced the market dynamics, and the overall functioning of Private Markets.

1. **The expansion of Private Markets**

   Over time, private markets have expanded and diversified. There are several drivers underpinning this expansion. These include:

- **An insufficient number of public investment opportunities**

  By way of illustration, even ignoring direct retail and institutional investment, the expected size of the superannuation industry in 2025 (~A$6.5 trillion) will outsize the value of ASX listed equities by approximately 2 times, highlighting a gap between available public investment opportunities and the growing amount of capital to be deployed.

- **A rapid increase in demand for global Private Capital**

  Global private fund managers are targeting offshore markets, including Australia, for investments in Private Equity (PE), venture capital, infrastructure, real estate, and private debt assets. This demand is driven by the need for diversification, stable cash flows, inflation-protected assets, and aiding energy transition.

- **Structural shifts in investment**

  Australia has seen a structural shift with increased global capital inflows combined with a decline in traditional real money managers due to a shift towards passive investments/exchange traded funds (ETFs). One outcome of this has been inflated public market valuations, making private market alternatives more attractive for value creation and a buffer against short term volatility seen in public markets.

- **The increased availability of Private Debt and Private Equity funds**

While still small compared to global growth, the emergence of private debt funds in Australia, both from global and domestic sponsors, have significantly increased liquidity in private debt and equity markets. As an illustration of how this impacts the PR more secondary and tertiary PE asset sales, reducing reliance on trade sales and IPOs as exit avenues for PE sponsors. PE funds have also been seeking to increase their exposure to new investors through listed products.

These factors are further accentuated by a key transition in the market. The growth in fund sizes and concentration amongst the top tier of global asset managers has enabled participants to finance larger deals while maintaining prudent diversification parameters. As a result, we note that large globally active private markets participants have become more integrated into the broader financial ecosystem. Private fund managers are now co-lending or acting as a lender on syndicated loans, sharing risks and leveraging each other's strengths. This has helped private fund managers access a wider range of investment opportunities and prov more comprehensive financing solutions to borrowers.

We also note that private fund managers are concurrently evolving their investor bases in order to scale even further. While traditionally targeting institutional investors, the potential investor pool has broadened to now include Ultra High Net Worth/High Net Worth individuals and family offices with a number of private fund managers actively working to create models capable of managing "mini-millionaire", and mass affluent retail money. This transition, if successful may require private funds to evolve their capital call structure. This change would involve taking in capital upon initial commitment from retail investors in order to manage the risk that a retail investor cannot meet a capital call when requested. This will result in an increase in the drawn component of private fund investors' commitments with an increased reliance on banks' deposit taking capabilities.

2. The evolution of Private Credit

The evolution of private credit reflects a structural shift in private markets, combined with elements of cyclical positioning. Initially, private credit focused on providing loans to middle-market companies that traditional banks underserved. These loans were often structured as direct lending, where private credit funds worked directly with borrowers to originate and negotiate loans not traded in public markets.

Private credit is now active and well established in sectors traditionally dominated by banks. For example, private credit funds are now more active in providing capital solutions, such as junior debt financing, mezzanine debt, and hybrid capital, to borrowers who need flexible financing options.

The cyclical shifts: an important driving force in Private Markets

Cyclical shifts in private markets play a pivotal role in shaping the landscape of global finance and investment strategies. These shifts, driven by fluctuations in economic cycles, investor sentiment, and regulatory environments, create dynamic opportunities and challenges for market participants. Understanding and navigating these cycles is crucial for private market investors, as they influence asset valuations, liquidity conditions, and the availability of capital. By recognising the patterns and implications of these cyclical changes, investors can better position their portfolios to capitalise on emerging trends, mitigate risks, and enhance value creation.

Cyclical shifts at the asset and fund level have led to response by global private fund managers, particularly those focused on real asset private market investments and investments are now focused on longer hold periods for underlying asset investments. For example, PE firms are now holding assets beyond the traditional 3-5 year investment periods. This change is due to economic factors linked to the post-COVID environment, narrower exit options, inflationary effects on business earnings profiles, and, more recently, global uncertainty caused by US tariffs.

2. What impacts will the continual growth of superannuation funds have on Australia's capital markets?

Australia has ~$2.8 trillion in superannuation assets (outside of self-managed super funds). This is projected to be the second largest superannuation system globally within the next decade. Considering large institutional funds alone, Australia's pension assets have more than doubled over the past decade from $0.8 trillion to $1.7 trillion. This rapid growth exceeds the growth of Australia's investable market, which grew just 1.9 times. Australian pension funds' assets are now equivalent to approximately 67 per cent of the total Australian investable market.

Australian superfunds are becoming a dominant investor across Australia's capital markets, both public and private. The question is, as superannuation funds continue to grow, what implications will this have on capital markets?

a) **The rise of Mega Funds and the Deployment of Capital**

As a response to regulatory performance pressures, continued consolidation has heralded the emergence of Mega Funds (superannuation funds with over $100bn in assets), which now control over half of all superannuation assets. As funds have consolidated, incoming capital has grown rapidly, prompting funds to seek new investment opportunities globallyas domestic investment opportunities become oversaturated and yields less attractive.

Despite this, Australian pension funds continue to invest more in Australia than anywhere else, with billions invested into Australian infrastructure and other real assets along with ongoing significant investment in domestic public markets.

b) **The attractiveness of asset classes**

Given the challenges of scale and the search for higher risk-adjusted returns, superannuation funds are also moving further into private markets. Investments in PE, private credit, infrastructure and real assets offer opportunities for enhanced returns, portfolio diversification, and long-term investment horizons that align well with superannuation fund liabilities. This shift is changing the profile of superannuation fund portfolios, leading to more significant holdings in unlisted assets, which may impact the liquidity characteristics of the broader superannuation system over time.

c) **Risks to the stability of the financial system**

The increasing scale and international diversification of superannuation fund investments carries both stabilising and destabilising potential for Australia's financial system. On one hand, large, diversified institutional investors who are aligned with national initiatives and carry a degree of social licence can act as stabilising forces, providing patient capital during periods of market volatility. On the other hand, a larger proportion of assets in less liquid markets could expose the system to valuation risks, procyclical behaviour during stressed conditions, and complexities in managing liquidity, particularly during periods of economic stress when member switching or elevated withdrawals occur. Additionally, the growing global footprint of superannuation funds increases their exposure to global financial cycles and geopolitical risks, potentially transmitting international shocks more directly into the Australian economy and capital markets.

Given the growth in the superannuation industry and the increasing dominance as private capital investors, we are seeing that they are able to utilise this dominance to push for greater transparency in private markets. As an example, we have seen superannuation funds require fund managers to provide more comprehensive details about the underlying investments and assets within their portfolios. Additionally, with the expansion of valuation responsibility on the senior executives under the FAR regime, greater focus is being placed on oversight, frameworks and evaluation methodologies of the underlying fund managers.

3. Do regulators have access to the right data to understand the impact of changes in our capital markets on the economy?

Transparency of data from private markets remains limited, making disciplined valuation practices essential for maintaining confidence and liquidity in private markets. Regulators are likely to play an increasingly important role in ensuring transparency and consistency in private market practices and governance for valuing unlisted assets. This will help external managers demonstrate their reliance on such valuations. Poor valuation governance can lead to valuation write-offs within unlisted investments due to factors such as rising interest rates or constrained capital recycling opportunities.

While the high degree of transparency and disclosure required for public listed markets acts as a leading indicator of corporate health and provides an insight into economic outlook, it is not necessarily the case that increased transparency into private markets will have the same result.

4. What data do we have to understand how private capital – both debt and equity – will respond in a system stress scenario?

To effectively gauge the responsiveness of private capital to systemic stress, it is imperative to collect and analyse relevant data that can provide predictive insights and historical contexts. Historical portfolio observations evidence how private capital has responded to system stress (such as throughout the COVID pandemic). NAB have made the following observations:

- **The investment horizon is long**
  Private capital investors typically accept a longer-term investment horizon (5-10+ years). This enables them to maintain greater patience during periods of system stress, noting the illiquidity of the assets and the less frequent valuation approach. This was demonstrated throughout COVID, where, as a result of the extended duration between valuation dates, the pandemic had limited downside impact on valuation which remained largely stable during these periods. Investments were able to be managed appropriately, with new investments and exits timed to maximise value and avoid crystalising losses.
- **Equity support availability**
  Large private capital investors were willing to provide additional equity support to private assets which were under cash flow stress or were at risk of breaching leverage covenants.
- **Investment interest continued despite stress**
  Private capital funds continued to attract new investor commitments despite system stress. There was no deterioration evident in investor behaviour or their willingness and capacity to make capital calls, with no investor defaults seen across our global Funds Finance portfolio. Private capital funds also (generally) have appropriate redemption gates to minimise material liquidity events for open-ended funds, while close-ended funds are not subject to the same liquidity dynamics.

At the asset level there is limited data on how private capital fund managers responded to system stress during COVID. However, both global and domestic private fund managers active in the Australian and New Zealand market reacted similarly. Their first reaction was to ensure sufficient liquidity for underlying asset investments, achieved through drawing down unutilised debt or injecting follow-on equity. This response was evidenced in terms of restructures, follow-on equity support and longer hold periods for the assets.

5. What does market integrity look like in practice as more capital raising occurs outside public markets?

Market integrity is essential to maintaining trust and confidence in the financial system. As more capital raising occurs outside of public markets, the importance of upholding integrity does not diminish. Private markets can introduce new risks around transparency, fairness, and investor protection. Without strong standards of conduct and governance, there is a heightened risk of harm to investors, distortion of capital allocation, and erosion of public confidence in the broader market system. Safeguarding market integrity ensures that capital continues to flow efficiently, investors are treated fairly, and Australia's reputation as a well-regulated and attractive investment environment is preserved.

The following observations highlight the current state of integrity in private markets:

a) **The stability of private assets**

The value of private assets appears more stable than for some comparable asset classes, partly because valuations are typically less frequent and more subjective. While private funds must generally adhere to accepted accounting principles, these principles do not mandate specific techniques for asset valuation. Stale valuations may pose a risk to financial stability in the event of a macroeconomic shock leading to a broad reassessment of asset valuations across the sector. In Australia, APRA has recently revised prudential standards to strengthen the investment governance of superannuation trustees, including in the valuation of unlisted assets.

b) **Lower default rates**

Default rates in private markets have been relatively low and less frequent in recent times relative to comparatively risky investments, such as in the syndicated loan or high-yield bond markets. The sector has greater capacity than other forms of lending to postpone losses and defaults due to the bilateral or clubbed nature of lending agreements. This has made it more resilient thus far in the current cycle, but could increase the sector's vulnerability to large shocks.

c) **The strength of private credit**

With specific reference to private credit, the sector has also not endured a recession so there is little precedent to understand its resilience to a large downturn. Where there have been defaults, private credit typically has a higher loss given default. This may reflect a higher incidence of lower or poorer quality collateral or subordinated lending. Lending in the sector is typically medium term, and refinancing risk appears to be evenly distributed across the next five years.

What remains clear is that structures to optimise integrity in private markets are of benefit. These structures could include:

- Strong governance around valuations and decisions with clear accountability and oversight. This includes a clear and consistent valuation process and policies including independence of valuation functions with use of third-party advisors for valuations;
- Clear processes to identify and manage conflicts of interest including fees linked to valuations, transfer of assets, redemptions, investors subscriptions and remuneration; and
- Transparency with lenders, investors and regulators including regular reporting of valuations, fund and asset level performance.

6. Is the shift to private markets creating issues for retail investors such as reduced access to investment opportunities and greater exposure to risk, with fewer protections?

The increasing shift of capital to private markets has implications for retail investors, primarily around access to investment opportunities, exposure to risk, and the level of protections available.

Reduced Access to Investment Opportunities

Historically, investment in private markets has been limited to institutional and wholesale investors. However, there has been an increase in the development of new platforms and initiatives aimed at facilitating retail investor access to private markets. This indicates a growing trend towards making private market investments more accessible to a broader audience, including retail investors, under the banner of democratising markets. Additionally, the development of private capital ETFs by Australian and Global managers further supports the desired diversification of the investor base, although these have so far focused on listed illiquid assets.

Greater Exposure to Risk

Retail investors venturing into private markets are exposed to greater risks compared to traditional public markets. Key concerns highlighted include:

- Lack of regulation in private markets compared to public equity markets, leading to potential transparency issues and the absence of standardised reporting.
- Misalignment between fund manager incentives, related party transactions, and the treatment of confidential information which could impact investor interests.

These concerns underscore the importance of increased regulation, transparency, and reporting standards. While such measures would be net positives for clients by mitigating risks, there is an inherent cost to regulation and adherence, which may ultimately be passed on to investors.

7. Does there need to be greater harmonisation in the regulation of public and private companies?

The "democratisation of private capital" and the increasing presence of "retail" investors investing into these markets will, in our view, drive a need for greater convergence of regulation across private and public markets to protect investors. Without consistent regulatory expectations – particularly around disclosure, governance and conduct – there is a risk that retail investors will face greater exposure to opaque practices, higher risks, and lower standards of protection compared to public markets. Harmonisation does not mean identical regulation, but it should ensure that core principles such as transparency, fair dealing, and accountability apply wherever retail investor interests are at stake.

One of the primary concerns revolves around the availability of innovative products and liquidity solutions specifically designed to attract retail investors to illiquid assets. These assets, while potentially lucrative, may become particularly vulnerable during periods of market stress. Ensuring that these new offerings are robust and resilient is crucial to maintaining investor confidence and market stability.

It is noted that while increased regulation, transparency and reporting standards would be a net positive for investors, there is an inherent cost to regulation and adherence and this cost may be passed on to investors e.g., managers will be challenged to strike a balance between the costs of frequent valuations and downside risk of large shocks to high value assets.

8. How can Australia's capital markets remain attractive and meet future economic needs?

Australia's capital markets play a crucial role in supporting the country's economic growth and development. To ensure that these markets remain attractive and meet future economic needs, a multifaceted approach is required.

- **Clear regulatory guidance**
  Clear regulatory guidance is essential to maintaining the integrity of private markets. This involves establishing robust frameworks that ensure transparency, fairness, and accountability in all market activities. By providing clear and consistent regulation, we can protect investors, promote ethical practices, and foster a stable and trustworthy market environment. Such guidance helps mitigate risks, prevent malpractices, and enhance investor confidence, ultimately contributing to the overall health and resilience of private markets.
- **Education and Protection for Retail Investors**
  Global leadership in providing solutions for retail investors to participate in private markets is crucial. This includes offering clear education and protection to help retail investors navigate these markets effectively.

- **Fostering a Liquid Corporate Bond Market**
  To deepen and create a more liquid corporate bond market, especially for retail investors, barriers such as complexity and cost must be addressed. Solutions like adopting practices from the New Zealand market or revising the execution process for other products could facilitate better market access for both issuers and investors.
- **Improving Price Discovery and Transparency**
  Enhancing price discovery and transparency in private and public debt capital markets is vital for both issuers and investors. This can be achieved through more frequent listings of simple corporate bonds and better over-the-counter trading venue information, similar to the TRACE system in the US.
- **Educating Superannuation Holders on Credit Markets**
  As both private and public credit markets benefit from asset allocation shifts due to an ageing population, it is important to support the education of superannuation holders on credit markets as a defensive option compared to traditional equities.
- **Promoting Wealth Creation Opportunities**
  To enable retail investors to benefit from diverse wealth creation opportunities, it is necessary to promote the simple corporate bond framework further. Streamlining listing requirements to enhance retail investor access to Semi-Government and Government Bonds is also required.
- **Supporting Synthetic Risk Transfer**
  Gaining support from APRA to allow synthetic risk transfer from Australian bank balance sheets is important. This would enable banks to use public capital markets to manage balance sheet risk instead of relying on private credit through complex structured transactions.
- **Enhancing Public Market Health**
  The future health of Australia's public markets is systematically important to the economy and to the clients whose portfolios largely depend on these markets. Addressing the cyclicality of the IPO market and feedback regarding the costs and regulations in public markets can mitigate barriers for private market companies considering going public. This will also help retain ASX companies within public markets rather than shifting to private markets.

By implementing these measures, Australia’s capital markets can remain attractive and capable of meeting the future economic needs of the country.