IC Brief

PARA BELLUM ADVISORS

Synthetic Exposure Creation for a Constrained Mandate

Scenario Type: Australian Superannuation Fund – APRA-regulated, trustee-governed portfolio
Asset Class: Defensive Allocation – Synthetic EM Local-Currency Debt Exposure
Situation Type: Economically attractive offshore fixed-income carry identified but inaccessible due to mandate and governance constraints
Primary Issue: Structural return drag caused by legal, policy, and classification constraints rather than risk aversion or investment conviction

1. Decision Context

The defensive portfolio was behaving exactly as designed – low volatility, clean optics, and minimal governance friction – yet persistently under-earning comparable offshore portfolios.

The investment team had high conviction in the economics of emerging-market local-currency debt:

- Carry had normalised
- Correlation benefits were well understood
- Duration fit defensive objectives

The IC decision was **not** whether the exposure was economically sound. It was whether a structure could be implemented that would:

- Survive trustee, audit, and APRA scrutiny
- Preserve defensive classification
- Avoid reopening the trust deed or derivatives policy
- Remain defensible over time, not just at approval

This was a survivability decision, not an alpha decision.

2. What Changed

At mandate design:

- Defensive assets defined narrowly
- Derivatives permitted primarily for risk reduction
- Offshore carry opportunities not contemplated

By review:

- EM local-currency debt became institutionally mainstream
- Relative carry differentials widened
- Peers accessed exposure without governance disruption
- The fund's own framework prevented participation

The opportunity evolved. The mandate did not.

3. How the Risk Actually Manifests

The risk was not volatility or drawdown.

It was **structural return suppression** inside nearly half the balance sheet.

- Carry foregone annually for non-risk reasons
- Defensive book lagging offshore peers
- Inaction compounding quietly each year
- No governance-safe path to implementation

Doing nothing was safe. Doing nothing was expensive.

4. What Surfaces on Review

Consistent failure patterns emerged when options were assessed:

- Unfunded derivatives triggered "speculation" optics
- Technically compliant structures failed explainability tests
- FX exposure lacked clear ownership
- One-off workarounds passed IC but failed audit review
- Anything requiring contextual explanation proved fragile

This was not poor investment thinking. It was governance reality.

5. Structural Assessment

This was **not**:

- An APRA constraint
- A risk-budget issue
- A lack of conviction

It **was**:

- A legal-form and classification problem
- A mandate-architecture constraint
- A governance survivability problem

Any viable solution had to prioritise:

1. Defensive asset classification
2. Trustee and audit defensibility
3. Repeatability and longevity

Economic elegance was secondary.

6. Structuring Logic

Effective resolution required designing **from legal form backwards**, not from payoff forwards.

Key principles applied:

- Funded, AUD-denominated structure
- Investment-grade counterparty issuance
- Held and reported as a defensive security
- Explicit principal protection
- Economics linked underneath, not exposed on the surface

Bespoke reference construction prioritised:

- Liquidity
- Country concentration limits
- FX transparency
- Explainability over headline yield

The objective was not cleverness. It was institutional durability.

7. Intended Outcomes

When implemented correctly:

- Defensive carry improves without reclassification
- FX exposure is explicit, owned, and governed
- Trustees can explain the structure cleanly
- Audit and regulatory review focus on form, which holds
- The solution is reusable, scalable, and reviewable

The outcome is not yield optimisation. It is **structural optionality**.

8. IC Takeaway

This was not a failure of mandate design at inception.

It was the predictable consequence of legacy governance frameworks colliding with a changed opportunity set. In institutional portfolios, return drag caused by form is harder to see – and more expensive – than market risk.

Structuring restores access without forcing governance confrontation.

9. Applicability

Most relevant where:

- Defensive mandates are tightly defined
- Derivatives are politically sensitive
- Deed or policy change is slow or costly
- Trustee defensibility dominates decision-making

Less relevant where:

- Mandates explicitly permit return-seeking derivatives
- Offshore assets are uncontroversial
- Bespoke exceptions are institutionally tolerated

10. Engagement Path

Primary: Structuring-as-a-Service™ - Mandate interpretation, structure design, dealer coordination, governance-safe implementation.

Secondary / Bespoke: Reference basket design, FX framing, trustee narrative packs, replication and unwind frameworks

A full structural narrative is available for readers who wish to review the underlying mechanics, trade-offs, and remediation sequencing in greater detail.

Disclaimer

Illustrative scenario for discussion purposes only. Not a transaction summary or client-specific case study.