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Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuationtransparency@treasury.gov.au

Dear Sir \ Madam,

Improved superannuation transparency – portfolio holdings disclosure

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the request for comments in regards to Treasury's consultation on the exposure draft legislation with respect to improved superannuation transparency and, specifically, portfolio holdings disclosure.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation.

General comments

ASFA supports continual improvement in the disclosure of superannuation. It is critical that such disclosure be meaningful to members; not have the potential to mislead and be as consistent as possible across different products to enable logical conclusions to be drawn and comparisons made. In so doing a balance needs to be stuck between the cost of compliance and effective outcomes, to ensure that the provision of information is cost-effective.

We support the underlying policy rationale for meaningful disclosure of portfolio holdings, as we believe it is beneficial for consumers to be provided with certain information with respect to the assets underpinning their particular investment options(s).

General – overall portfolio holdings disclosure framework / requirements

ASFA generally supports the intent of the draft legislation and regulations. The simplified model of reporting investments of associated entities; the repeal of the notification and reporting requirements and the policy to protect confidential information about sensitive assets are welcomed. We also support the time lags in reporting information as that addresses concerns regarding the disclosure of commercially sensitive information. The revised requirements generally will be more practical and cost effective to implement than the original version.

There remain, however, some residual **concerns among some members with respect to the (lack of) value of the data** prescribed by the requirements of the draft legislation to consumers. Further, it is unclear as to whether the prescriptive nature of the regulations means that trustees are unable to go beyond the requirements. **We submit that funds should have the flexibility to enhance their portfolio holdings disclosure**, over and above the minimum, base-line, standards prescribed under the legislation, if desired. While the broad concepts were confirmed in ASIC's consumer testing, in practice the sheer volume and complexity of data disclosed will prove to be dramatically different to the relatively simple concepts which were tested. Members are of the view that, if consumer testing were performed utilising more realistic prototypes, the results would play out differently. Furthermore, the various gaps in data will not aid comprehension or comparability.

While delayed disclosure will assist, members are concerned that there may be some adverse implications which may result from requiring this level of disclosure, which ultimately will be detrimental to members. By way of example, to improve control, transparency and flexibility (to protect members' interests) funds often holds assets directly in their name under Separately Managed Accounts, which are then managed by external investment managers. As these are 'associated entities' this will necessitate disclosure of the underlying assets. Some investment managers have serious concerns about disclosing their positions (for example, trend followers who have large futures exposures which necessitate short term trading strategies) which may result in these managers insisting on managing the fund's mandates through their own vehicles and the members of the fund would lose the benefits of having Separately Managed Accounts.

While we understand and agree with the intent of the legislation we would like to see any detrimental side effects, such as those outlined above, minimised. Accordingly, one member has proposed that the following model for disclosure could be considered: -

- asset name
- asset type
- sector
- aggregate percentage exposure, at investment option level, to a prescribed number of assets in each asset class (the top ten assets in each asset class)
- only disclose the individual asset percentage allocation where the individual asset exposure exceeds five per cent exposure at the investment option level.

We believe that the above would be likely to meet the members' interests for disclosure, without compromising the positions held.

Other potential alternatives that members have raised include

- requiring full disclosure being completed on an 'as required' basis, in response to a specific query; or
- the provision of an interrogate-able database, as opposed to publishing the full list.

It should be noted that the resources and costs which are likely to be required to manage the production of portfolio holdings disclosure and handle queries is still likely to be fairly significant, and will reduce returns to members.

ASFA appreciates that Treasury has responded to past industry submissions, however, there are a number of newly introduced items in the draft legislation and regulations which will necessitate more analysis than was achievable in the time available and some which will require further clarification.

Given the importance of ensuring that the portfolio holdings disclosure regime is properly designed and the legislation drafted effectively we are concerned that the consultation period provided by Treasury occurred over the Christmas \ New Year and summer holiday break, when a number of our members are either on leave or have had little time to consider the ramifications of the proposed draft legislation. **Given the timing of this consultation it is possible we may receive feedback from members after making this submission - if this occurs we would appreciate the opportunity to raise any matters of significance with you.**

ASFA would welcome the opportunity to discuss portfolio holdings disclosure with you further.

Below we have raised some specific policy issues and operational concerns with respect to the exposure draft legislation.

Specific comments on the draft legislation

1. Superannuation Legislation Amendment (Transparency Measures) Bill 2015 (the Bill)

Directly held products / property and look through for associated entities

Members have requested clarification as to what precisely is meant by "look-through" and "levels". We note that the regulations use the term "level" but they do not define what is meant by this.

Asset managers will provide to the superannuation fund the investment options which are listed in the fund's PDSs. The investment options of a particular product often involve investing in internal pooled trusts, the Responsible Entities of which are associated entities to the RSE licensee, and which are not offered externally at all.

One member has suggested that, in example 1.1 provided in the Explanatory Statement, they would disclose Eagle Six and Atar before the 'end investments'. As such, it is not clear how this would benefit members and users of the data, when it is the end investment which has been invested in to maximise returns for members. This member has suggested that, if the internal pooling trusts are disclosed in the table in Schedule 8F, this data will not be consistent with the current data provided to, and published by, research houses like Morningstar. This will confuse members and users of portfolio holdings data.

The question has also been raised with respect to investment options in classes of products within a superannuation fund. A number of superannuation funds employ a structure whereby different classes of products are offered within the one superannuation fund. Many of the same investment options (particularly the 'pre-blended' or 'managed' funds) will be offered across the range of products. Clarification is required as to whether what is to be provided is: -

- a consolidated view of investment options, irrespective of which product class they are in; or
- the investment options set out on a per product / per class basis.

Reporting dates

The proposed amendment to section 1540 will mean that sub-section 1017BB(1) will apply in relation to a reporting day which is 31 December 2016 and to later reporting days. Implementation by 90 days after this this reporting date is likely to be particularly tight, given that the Bill and Regulations are unlikely to be finalised until mid-year, other legislative changes that will need to be implemented at this time and the need for IT requirements (such as website design). Given this may not allow sufficient time for full implementation, **it may be worthwhile considering amending the first reporting date to 30 June 2017.**

Application to legacy products

Proposed new paragraph 1017BB(4)(b) of the Bill exempts any of an entity's investment options which have been closed to new members for at least five years. ASFA supports this decision, as the inclusion of these products would have imposed a significant burden on providers to update multiple legacy systems, which would have been unjustifiable, given these products have been closed to new members for some time.

We welcome the proposed "closed to new members for at least five years" test as we believe this is simple for the industry to apply in practice.

Treatment of annuities in an investment option

ASFA believes that the reporting of the underlying assets of an associated life company, on a look through basis, with respect to guaranteed life policies is not appropriate. **We support the proposed amendments to classify guaranteed life policies as directly held investments of the RSES licensee, whereby only the relevant life office statutory fund(s) need be reported, with no requirement to report the underlying investments of the statutory fund on a look through basis.**

Protection of confidential information about commercially sensitive assets and non-disclosure agreements

ASFA appreciates that the proposed new paragraph 1017BB(4)(c) provides an RSE with the flexibility to select a limited number of assets (up to five per cent of the assets attributable to an investment option), which it considers to be commercially sensitive, to exclude from disclosure.

Members, however, have serious concerns about disclosing asset valuation details for private assets. Publishing the latest valuation of large illiquid assets may limit the ability to achieve a competitive price on sale.

With respect to unlisted (direct) assets, disclosure of the book value will put the superannuation funds at a material commercial disadvantage with respect to all other participants in the market, who do not need to disclose such information. This will have a deleterious effect upon the investment returns of members of those funds.

By way of example is the experience of one large fund: -

- it successfully acquired an additional interest in an existing asset through the exercise of a pre-emptive right at a discount to the fund's book value. Had the fund been in the position of having to disclose its book value, the market would have "bid up" the asset to at least an equivalent level thereby eliminating any advantage to the fund and denying its members the opportunity to acquire an investment at an attractive price;
- it sold an asset at a price above the fund's book value. In a difficult market, as was the case, the likelihood of receiving an offer at or above book value was unlikely and had the fund been forced to disclose its book value to the market the opportunity of making a sale above that value would have been lost.

It is important to note in this context that no other business entity in these markets is subject to similar disclosure requirements. This places superannuation funds at a considerable disadvantage and represents a considerable distortion of the market.

In addition, members also have concerns around existing non-disclosure agreements, such as some private equity, hedge fund, joint venture and co-investment arrangements.

We are concerned that the use of a proxy of five per cent may lead to two potential outcomes: -

- **the under-disclosure \ non disclosure of up to five per cent of assets which are not in fact commercially sensitive;**
- **the need for trustees to make applications for relief to ASIC, under section 10120F of Part 7.9 of the *Corporations Act 2001*, in circumstances where the value of a genuinely commercially sensitive investment exceeds five per cent.**

ASFA is of the view that is should be possible to determine principles by which trustees can determine, and be exempted from disclosing the market value of, commercially sensitive information. This could include investments where the current market value is not a matter of public record (for example, a direct interest in real property).

We understand that there may be a precedent for the concept of "commercially sensitive" information, adopted by the Australian Bureau of Statistics when disseminating statistical information, which could form the starting point for an appropriate principles with respect to determining of commercially sensitive information.

An alternative may be to allow the RSE to disclose the nature or type of the asset using general wording (rather than identifying the asset by specifically naming it) and to provide the consumer with sufficient information about the nature of the asset to aid transparency of asset concentration and overall portfolio risk. Conversely the asset could be named but the value not disclosed.

Provision may also need to be made to accommodate investments which are subject to a (commercially essential) confidentiality undertaking, such as certain private equity investments.

Investments which are not material in accordance with the regulations

Proposed new paragraph 1017BB(4)(e) provides that investment in financial products or property which is not considered to be a material investment in accordance with the regulations need not be disclosed.

In order to make this disclosure meaningful to members and not prohibitively costly to produce we submit that **a strong materiality threshold is needed in the regulations.**

Possibilities which could be considered include investment options with funds under management (FUM) over a prescribed amount, or disclosing assets which exceed a specified value. Another alternative may be to display the top 50 assets for each investment option.

Subsection 1017BB(4) - drafting issues

The drafting of sub-section 1017BB(4) is particularly confused and cannot be easily interpreted or applied. By way of example: -

- the introductory words of sub-section (4) end with the word "if", however, that does not lead appropriately or meaningfully into the various paragraphs (other than paragraph (a), where the "if" is duplicated anyway)
- paragraph (b) - the reference to "that has" should be replaced with "that have"
- in paragraph (e) there appears to be a typographical error, where a stray return and "(iii)" have been inserted
- the sentence following this - the last sentence of paragraph (e) - really belongs in paragraph (c), to which it explicitly refers.

Proposed new sub-section 1017BB(6) – the definition of "investment option"

This definition is confusing, especially as it is an "inclusive" definition but only cites two examples; and is inconsistent both with definitions in the SIS Act and industry practice.

Ordinarily:

- the financial product is the superannuation fund
- the trustee can issue different classes of beneficial interest in the superannuation fund (commonly referred to as products but which are not considered to be financial products under the Corporations Act), each of which has its own PDS, which in turn contains one or more investment options
- a MySuper product is often an investment option/strategy within a product (fund) rather than a stand-alone product (fund)
- all investment options / strategies which are not a MySuper option within a product (fund) would be considered to be a "choice" investment option.

Accordingly, this warrants re-drafting, although we acknowledge that there is now the limitation that the definitions of "choice product" and "MySuper product" in the SIS Act do not reflect most product structures in practice. Were it not for the limitations of the existing definitions of MySuper product and Choice Product, alternative drafting could be along the lines of "Investment option includes an investment strategy within a class of beneficial interest. The investment strategy may be a choice strategy or a MySuper strategy".

Other drafting issues

As item 9 of the draft amending Bill repeals sub-paragraph 1022B(1)(h), consequential amendments are required to sub-paragraphs 1022B(2)(f), (7)(b) and (7C) or 1022B(3)(g), all of which refer to sub-paragraph 1022B(1)(h).

2. Superannuation Legislation Amendment (Transparency Measures) Regulations 2015 (the Regulations)

How information must be disclosed

Proposed new regulation 7.9.07ZA prescribes how portfolio holdings information must be disclosed, while Schedule 8F set out an example of how the information is to be disclosed. The drafting in regulation 7.9.07ZA is very difficult to interpret and apply.

Proposed new sub-regulation 7.9.07ZA(1)(f) provides that column 1 of the table must use "a method chosen by the trustee … to identify and distinguish the classes (or levels) of financial products or property covered by paragraphs (3)(a), (b) and (c)". There is no requirement that the trustee disclose or explain the method adopted, which raises the prospect that trustees may adopt different methods which may not be apparent to the user and may impede comparability.

Furthermore, sub-regulation (i)(f) refers to "the classes (or levels) of financial products or property". This implies that "classes" and "levels" can be used interchangeably. In ASFA's view, however, these words have different meanings – you can have multiple classes within a financial product. We suggest that, if use of a synonym is considered necessary, that "layers" be substituted for "classes" as it has a similar meaning to "level".

Proposed new paragraph (1)(g) relates to the asset identification method to be used by the trustee in column 1. This sub-regulation, however, then proceeds to state how the different levels of products should be set out in column 1. In our view column 1 need only set out the trustee's identifiers for each level of investment, and should not contemplate listing products in column 1. In so doing it appears as though the sub-regulation potentially crosses into the subject matter of sub-regulation (3). Accordingly, it is unclear as to how paragraph (1)(g) and sub-regulation (3) will work together. We suggested that drafting for paragraph (1)(g) could be along the following lines

> "*using this method, column 1 of the table must*
>
> - *allow for each level of financial products or property, and*
> - *for each financial product or property - assign a sequential identifier which is different from the identifier for every other level of financial product or property*."

Proposed new sub-regulation (3) is difficult to follow and potentially doubles-up the subject matter of paragraph (1)(g). We query whether the current drafting in sub-regulation (3) is needed at all, given that the information requirements only become clear on viewing the table in Schedule 8F. Accordingly, we suggest replacing the wording in sub-regulation (3) with the (much shorter) wording in paragraphs (1)(g)(i) and (ii), while the concepts currently set out in sub-regulation (3) should be set out underneath the table in the form of annotated guidance to the table. Attempting to describe in words concepts and ideas which only become clear when illustrated by means of an example will lead to confusion. It may be preferable to create the regulatory obligation through the means of prescribing the format of disclosure, through means of a worked example, as opposed to attempting to describe the content.

Information about derivatives

Under proposed new regulation 7.9.07ZB it is unclear on what basis derivatives are to be disclosed. In particular, it will need to be clarified **whether derivative are to be disclosed on an "effective exposure" basis or the value of the actual asset.** This will need to be resolved.

Members have also raised the concern that publishing a full list of derivative positions, which are generally rolled on a regular basis, means that others in the market are aware of the size of positions and able to take advantage of this information.

Regulation 7.9.07ZC – drafting issues

Regulation 7.9.07ZC is titled "Organising information about derivatives" – this appears to be a typographical error (repeating the heading for regulation 7.9.07ZB) as Schedule 8F appears to be the format for disclosing ALL portfolio holdings disclosure. If this is an error in drafting, the heading of regulation 7.9.07ZC should be replaced with wording to the effect of "Organising portfolio holdings information" or, perhaps more appropriately, regulation 7.9.07ZC should be moved to form a new sub-regulation 7.9.07ZA(4).

Schedule 8F – Way to organize portfolio holding information

The example table on page 17 of the draft regulations mistakenly refers to regulation 7.9.07X, as opposed to the regulation 7.9.07ZA. Furthermore the example table does not comply with the requirements in sub-regulation 7.9.07ZA(1) – there are instances of inconsistent terminology in the table which do not adhere to the regulatory requirements.

By way of example: -

- the heading of column 5 should be '**Price per unit'** in accordance with sub-paragraph 7.9.07ZA(1)(c)(v), not '**Price of unit'**; and
- the final row of the table should be displayed as '**TOTAL**' (in bold capitals) in order to comply with paragraph 7.9.07ZA(1)(h).

ASFA is concerned that the current approach to organising portfolio holding information may produce more complex disclosure, which is less meaningful for members.

Requiring 'assets derived from assets' to be included means disclosure is made across multiple levels of investments without sufficient clarity of actual holdings. In particular: -

- requiring 'assets derived from assets' to be included means disclosure is made across multiple levels of investments without enough clarity of actual holdings
- providing details of the intervening structures (e.g. direct ownership or investment vehicles) does not help a member to understand that, in total, they have a certain percentage of their superannuation invested in specific assets, for example BHP shares or a particular infrastructure investment
- listing dollar amounts for each layer of assets is less meaningful than setting out the total percentage of the investment option allocated to that asset. Disaggregated dollar amounts (raw data) are less meaningful to a member than a percentage of total allocations
- requiring the number of units and the unit value, as well as the total dollars, only serves to add unnecessary complexity, given the likely volume of assets which will need to be disclosed.

Requiring the publication of all direct and associated entity holdings will still produce a large list – members have indicated that for some of their options this will run to several thousand lines of data. This means that it would still be unwieldy and complicated for members to gain any real insight into their holdings. Requiring all positions to be reported would necessitate members having a sufficient level of sophistication to be able to calculate these positions as an aggregate. This goes against the transparency sought to be achieved by the legislation.

In addition, the regulations and the table do not appear to require an order for setting out the assets in each level (by way of example, they are not listed in order of total amount invested from highest to lowest). Members have sought confirmation that this mean that no such order is required.

Finally, members have queried whether Schedule 8F is a prescribed format to which additional wording cannot be added. This will need to be clarified, as members would prefer that there be flexibility to allow additional explanatory information to be included.

3. Explanatory Statement to the Regulations – issues with drafting

Example table

The example table on page 13 of the Explanatory Statement does not comply with the requirements in regulation 7.9.07ZA. There are a number of instances of inconsistent terminology in the table which do not adhere to the regulatory requirements.

By way of example: -

- the heading of column 2 should be '**Name of that product or property**' in accordance with sub-paragraph 7.9.07ZA(1)(c)(ii)
- the heading of column 3 should be '**Number of units held in that product or property**' in accordance with sub-paragraph 7.9.07ZA(1)(c)(iii)
- the heading of column 4 should be '**Number of units held in any final product or property**' in accordance with sub-paragraph 7.9.07ZA(1)(c)(iv)
- the heading of column 5 should be '**Price per unit'** in accordance with sub-paragraph 7.9.07ZA(1)(c)(v)
- the final row of the table should be displayed as '**TOTAL**' (in bold capitals) in order to comply with paragraph 7.9.07ZA(1)(h).

Further, some of the information is not especially meaningful. By way of example, the category of "government bonds" is significantly less useful than a summary which shows the issuing entity and duration (for example, 10-year NSW Government bond maturing May 2017 versus a 30-year US Treasury bond maturing June 2020).

Nature of asset

Page 15 of the Explanatory Memorandum states that

> "*RSEs will be required to publish, for each of its investment options, information about* ***the nature*** *and value of financial products*" (emphasis added).

This reads differently from the draft Bill which specifically requires that financial products must be identified, which has been interpreted as the financial product having to be named.

As discussed early in the submission, a preferred outcome would be that, where the asset is commercially sensitive or subject to a confidentiality undertaking, the trustee could have the option of stating the nature of the asset, as opposed to specifically identifying it.

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Should you have any queries or comments with respect to this submission please do not hesitate to contact me on (03) 9225 – 4021 or via email fgalbraith@superannuation.asn.au.

Yours faithfully

Fiona Galbraith
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