

# Submission

Retirement Income Policy Division, Treasury

## Your Future, Your Super Regulations and associated measures

Submission from Aware Super

25 May 2021

# Submission to Treasury

## About Aware Super

Aware Super (the new name for First State Super) has been the fund for people who value the community since 1992. We're one of Australia's largest funds and we're continuing to grow.

We merged with VicSuper and WA Super in 2020 and manage approximately \$140 billion in savings, including \$31 billion in retirement assets, for more than one million members located across the country. Our members—including teachers, nurses, public servants and emergency services officers—work in roles that support our community, and they expect us to do the same by investing in ways that do well for them, and good for all.

## Summary of concerns with regulations

As noted in previous submissions, we support the Government's intention to improve funds' performance across the sector and to increase transparency and we welcome the inclusion of administration fees.

We have a few core remaining issues with the regulations highlighted in the table on the following page. We provide additional detail on these concerns in the individual sections.

<p><b>Performance benchmarks must help consumers, including pre-retirees</b></p>	<ul style="list-style-type: none"> <li>• The current proposal does not cater for the differing needs of pre-retirees because it does not recognise the value of risk management for them.</li> <li>• A single "other" category is inadequate and will discourage lower risk alternative investments. We suggest broadening this benchmark to cover five categories (with a minimum of two additional categories "Other Growth" and "Other Defensive") as these investments may have a crucial role to play in diversifying portfolios given historically low yields expected going forward.</li> <li>• The unlisted infrastructure benchmark is not yet mature, and its current construction makes it unsuitable as a performance benchmark.</li> <li>• The YourSuper comparison tool for consumers should incorporate a contemporaneous measure of risk and reflect the current product structure/characteristics to ensure the selection of products is made on the basis of informed and relevant comparisons.</li> <li>• The underperformance letter should differ for Trustee Directed Products to allow trustees to provide limited prescribed explanatory information where it is likely that certain product features will have informed their choice, for example relating to their risk appetite, insurance, and/or specific interest portfolio choice (eg ESG).</li> <li>• It will be important for APRA to be able to exercise discretion in limited circumstances and a review of the strengths and weaknesses of the YFYS framework and methodology should be undertaken after two years.</li> </ul>
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<b>Staple only to high performing funds</b>	<ul style="list-style-type: none"> <li>• The ATO stapling criteria should be able to identify products which have been excluded from receiving new members and not staple members to these.</li> </ul>
<b>Portfolio Holdings Disclosure</b>	<ul style="list-style-type: none"> <li>• For unlisted assets such as infrastructure and private equity, the value for each unlisted asset should be disclosed as a range instead of a single dollar value. This is because providing a single value for each unlisted asset informs the market of a potential sale price for that asset, thereby limiting the price that can be achieved because buyers will anchor to the disclosed price.</li> <li>• Disclosing similar assets in groups will be more meaningful for cash, fixed interest and derivatives.</li> <li>• A materiality measure would be useful in providing meaningful information to members and for containing costs.</li> </ul>
<b>Annual Member Meetings</b>	<ul style="list-style-type: none"> <li>• There is a risk that the additional disclosure requirements will lead to dated Member Outcomes information being provided</li> </ul>

*The following sections address each area of concern separately.*

## 1. Performance regulations must help consumers

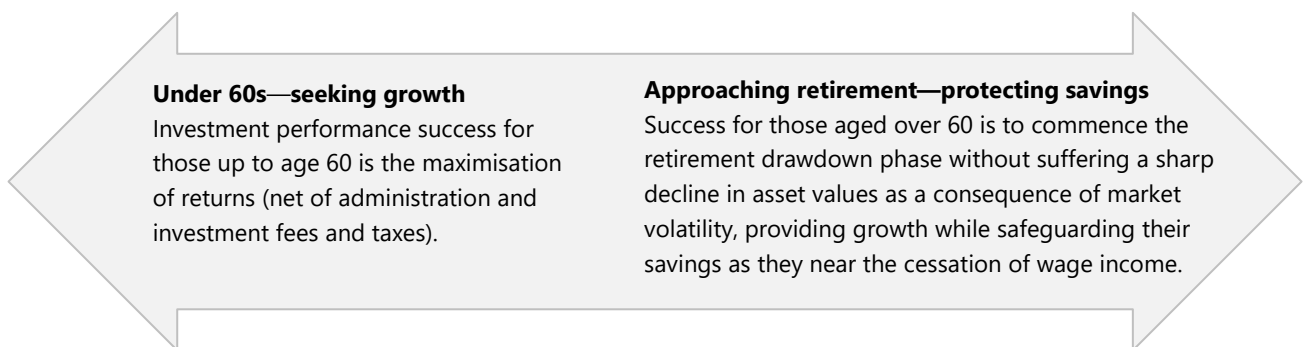
We are broadly supportive of the Government’s intent behind the YFYS reforms to lift competition and performance across the industry. However, we see challenges with the methodology proposed in the regulations.

### 1.1 Regulations ignore members’ changing risk profiles, creating issues for the pre-retiree segment

We note the proposed performance test applies a single approach across the entire accumulation phase, which assumes that the needs of all accumulation members are the same.

For most accumulation members aged up to 55, we agree with the assertion made in the regulations that the needs of default members are best served by maximising their potential for growth.

However, insufficient consideration of risk within the proposed performance test creates a significant challenge for trustees looking to fulfil their fiduciary duty to act in the best financial interests of their members as they approach retirement. Our extensive research into the drivers of retirement outcomes has highlighted that the needs of pre-retirees are best met by strategies that seek to balance the need for growth with the need to safeguard their retirement savings. We note that this cohort is more sensitive to market losses than to gains.



For our typical pre-retirees, who are five years from retirement, their large balances— relative to their contributions—make them more vulnerable to sequencing risk. This risk has been well documented by Professor Drew of Griffith University in his “retirement risk zone” research, in which he confirms this risk impacts members in the years leading up to retirement as well as the initial period in retirement. In other words, their money-weighted returns are much more likely to deviate meaningfully from the time-weighted returns that are the focus of this test. Indeed, high risk investment strategies that solely aim to maximise returns, are generally inappropriate for pre-retirees as they risk leaving them in a significantly worse position at, and through, their retirement.

### **Pre-retirees are more vulnerable to large market falls:**

If invested in a growth oriented MySuper strategy, a 'typical'\* 60 year old member, retiring at age 65, would have retired with ~\$182K in June 08 just prior to the GFC. A member with the same circumstance who happened to be retiring a year later (June 09) would have retired with a much lower balance of ~\$150K. They would need to work for ~2.5 more years to retire with the same \$182 balance, which they would have been expecting prior to the market falls. A more risk managed approach to investing their savings can reduce this impact considerably.

While it is true that many members have a long investment horizon at the point of retirement, the impact of large market falls on their superannuation balance just prior to retirement can have a significantly detrimental impact on their plans. Members in good health, who have discretion over their retirement date, can mitigate the impact of this by choosing to work longer where necessary. However, Core Data research suggests this is not the case for ~50% of retirees<sup>1</sup>, and we know this is not the case for many cohorts of our membership, especially those whose careers were physically arduous, including nurses and emergency services workers.

Managing risk in the lead up to retirement also aligns with the preferences of the majority of our pre-retiree members (based on member research, advice relationships and the active choices of our more engaged pre-retirees). It is clear that this cohort values peace of mind and the confidence to plan for their retirement.

The Government acknowledges these issues exist for pension members, and pleasingly, have excluded pension members from the YFYS in recognition of the broader aims of products in the pension phase. We urge the Government to consider and recognise that these same issues and differentiated needs apply to pre-retirees—those who are 5 to 10 years out from retirement (for our membership those aged 60 and over)—in the same way that they apply to pension members.

Unfortunately, the lack of recognition of risk management in the current construct of the performance test results in a high level of basis risk for risk managed strategies. This includes tail risk

### **It is important to recognise the value of risk management for pre-retirees to enable Trustees to act in their Best Financial Interests**

For example, our *Liquid Alternatives Defensive* strategy, in which the Balanced Growth Option invests, returned approximately 35% over the March quarter 2020, meaningfully offsetting the impacts of the COVID-19 related market falls for our pre-retirees, and driving strong peer relative performance outcomes through this period. Through its focus on tail risk hedging, this is our most defensive asset class - targeting very modest returns through the cycle, but significantly positive returns during large market falls.

The Government's proposed more *growth oriented "other" benchmark* that returned approximately 9% over the past decade is an inappropriate benchmark for a defensive strategy. Having a single benchmark for all "other" strategies is simply too blunt to recognise the value to pre-retirees from the risk management that can be afforded by defensively oriented alternative strategies. Under the proposed regulations, this sector is likely to create a persistent and cumulative drag on performance test outcomes, which may make it impossible to retain the risk managed focus of our Balanced Growth option.

<sup>1</sup> Source: Core Data Best Possible Retirement 2020 found 50.2% of Australians are forced into retirement by a factor out of their control

\* Taken to be a member with the typical balance and contributions of 60 year old Aware Super members

hedging which seeks to generate outsized returns during large market falls, to cushion the impact of volatile periods on the total portfolio.

These constraints place the Trustee in the unacceptable position of having to choose between managing for performance test outcomes and its fiduciary duty for this cohort of its members.

**It is critical that the Government reviews, and amends the performance test for pre-retirees,** such that it adequately recognises the value of risk management – tail risk hedging in particular – built into products that are predominately used by / target pre-retirees. We suggest that either:

- APRA be given the discretion to consider the peak to trough performance, and or risk-adjusted performance (Sharpe-ratio) of products that actively target pre-retirees. If, on these measures, products have demonstrably safeguarded members retirement savings in the lead up to retirement, and are meeting their CPI+ investment objectives, they should not be considered as underperforming, irrespective of their performance test outcomes. Failure to provide this protection or meet their long term investment objectives, combined with poor outcomes against the performance test would combine to indicate genuine underperformance for the pre-retiree cohort.
  - An example of products like this is the Aware Super Balanced Growth option, which follows a risk managed investment strategy that aims to balance the need for growth with the need to limit the impact of large market falls. This approach has been adopted because this product is predominantly used by pre-retirees (the vast majority of members are over 60 - default MySuper members are invested in the Balanced Growth option just prior to retirement for approximately 3 years under our new lifecycle design, and it is commonly chosen by our more engaged members in the lead up to their retirement); and/or
- Broaden the "Other" asset class benchmark to reflect a range of risk buckets, including one that more closely aligns to the objectives of defensive alternatives like tail risk hedging strategies. This concept is discussed further in the next section below.

### 1.3 A single "other" category will hamper innovation and impair portfolio diversification

We note that the single "other" category will make select investments un-investible – in particular, lower risk alternative investments will not be tenable under the proposed methodology.

The nature of the proposed performance test creates a new 'basis risk' that funds will seek to manage given the severe consequences associated with underperformance. The long (7-8 year) time horizon of the test helps ameliorate this issue for assets whose benchmarks provide a reasonable / representative forward looking return target. As noted in the previous section, the use of the proposed single "other" category is inadequate as it will capture a widely variant mix of high and low risk non-traditional investments:

- Those at the lower end of the risk/return spectrum (i.e. which sit within the defensive component of a diversified investment option), will typically target a much lower return than that implied by the 50:50 equity and bond benchmark for this category,

- Indeed, due to strength in both equities and bonds over the past decade has returned approximately 9% over this period and is expected to return approximately 7% on a forward looking basis which means that defensive strategies will inevitably appear to underperform to this benchmark,
- The mismatch creates a persistent and cumulative drag on performance test outcomes for defensive alternatives that will render these assets un-investable.

We understand this benchmark arose as a result of analysis undertaken by the Productivity Commission. We can see the use of a 50:50 equity and bond “other” benchmark might make sense when averaging out the performance of many alternative investments as a means for assessing performance across the industry.

However, in the case where this approach is applied to individual products, that may hold just one or two “other” investments, the representativeness of the benchmark’s expected return is important.

This is a significant concern in the current environment, in which interest rates and yields are at historic lows. It means traditional defensive assets will generate unusually low returns over coming years and are unlikely to provide adequate diversification during the next bout of market volatility. It is more important than ever before that we explore alternative defensive investment opportunities, including the use of long volatility and option-based protection strategies. Limiting this innovation risks unduly exposing investment portfolios (and hence members’ retirement savings) to the risk of large losses.

**We propose the Government take steps to limit this unintended consequence by broadening the “other” category to include ideally five discrete risk buckets, ranging from 100% equities to 100% bonds** – shown in the table below. At a minimum, the addition of an “Other defensive” category is essential, so we end up with “Other growth” and “Other defensive”.

APRA could work with industry to nominate a list of investments/asset classes which fit in each risk bucket. In our case, we have two different approaches to investing in Liquid Alternatives, reflecting the differing needs of members across our Fund. Growth Liquid Alternatives aim to achieve CPI+4.5% p.a. over the long run with half the risk of equities. Defensive Liquid Alternatives as discussed above are designed to deliver strong returns and liquidity during periods of extreme market stress, delivering low positive returns over the long run and we would see them fitting within the following possible buckets as shown below.

Equities	Bonds	Asset Class
100%	0%	
75%	25%	
50%	50%	Growth Liquid Alternatives
25%	75%	
0%	100%	Defensive Liquid Alternatives

#### 1.4 Benchmarks – unlisted and “Other”

We are aware of widespread criticism of the initial proposal to compare unlisted investments in property and infrastructure to listed benchmarks. We do agree with the observation that there will be sometimes material deviations in short term returns of unlisted assets and the listed benchmarks, but in most cases, these would be expected to even out over the long run. In the event that they do not we would expect APRA should be able to use discretion to look through “technical” failures of the performance test, for example by looking at performance over the 7 year and 9 year horizons, and recent performance trends. Since the objective of the test is to identify persistent underperformers, the use of discretion in such situations would strengthen the framework.

We believe there are a number of key attributes which are desirable in a benchmark to be used in the Performance Test.

- Long term return – most importantly it is essential that the long term expected return of the benchmark is a reasonable hurdle to assume for the relevant asset class.
- Transparency – Trustees must be able to understand the index construction and the expected risk and return attributes of the benchmark in order to assess the suitability of their current investment strategy and the risk of falling behind the Performance Test.
- Robust – free from significant revisions – as a regulatory hurdle rate with significant consequences, it is essential that the benchmark be fair in its construction and not subject to regular material revisions (to avoid undue survivorship bias arising from those assets).
- Investible – while not essential, a benchmark which is investible provides the Trustee with a means of achieving the long term return objective, and the option then to take active risk away from the benchmark in a measured way. An un-investible index poses problems for the Trustee in assembling an asset class exposure which can match the long term expected returns of the benchmark - basis risks will be significant. This is particularly problematic for unlisted assets as an un-investible benchmark limits the ability for Trustees to manage their actual exposure to their strategic asset allocation (noting these investments are lumpy by nature).
- Timely – index returns should be available monthly and within a reasonable period of time in order to facilitate the orderly calculation of the Performance Test benchmark.
- Short term return – it is desirable but not essential for the short term return of the benchmark to be aligned to the expected short term returns for the relevant asset class. As noted above, we believe that prudent use of APRA’s discretionary powers can be used to address the lasting impact of these short term deviations as they move through the rolling 8 year Performance Test window.

In the table below we assess the original listed benchmarks and two proposed unlisted benchmarks for the property and infrastructure sectors against the key benchmark criteria.

<b>BENCHMARK CRITERIA</b>	<b>Listed Property*</b>	<b>Unlisted Property**</b>	<b>Listed Infrastructure^</b>	<b>Unlisted Infrastructure^^</b>
<b>Representative long term return</b>	✓	✓	✓	✓
<b>Transparency</b>	✓	✓	✓	✗



<b>Robust</b> (free from revisions)	✓	✓	✓	✗
<b>Investible</b>	✓	✗	✓	✗
<b>Timely</b>	✓	✓	✓	✗
<b>Representative short term return</b>	✗	✓	✗	✓

\*Listed Property – S&P/ASX300 A-REIT Total Return Index and FTSE EPRA Nareit Developed ex Aus Rental 100% Hedged to AUD Net Tax (Super) Index

\*\*Unlisted Property – MSCI/IPD Mercer IPD Australian Monthly Wholesale Property Fund Index – Post-fee Total Return (All funds)

^ Listed Infrastructure – S&P Global Infrastructure Hedged Net Total Return AUD Index

^^ Unlisted Infrastructure – MSCI Australia Quarterly Private Infrastructure Index (Unfrozen) – Post-fee Total Return (All funds)

The unlisted property benchmark has most of the desirable attributes of a benchmark and addresses the short-term return mismatch that was an issue with the previous listed benchmark. While it is un-investible, in the sense that it would be very difficult if not impossible for a Trustee to assemble an asset class exposure in line with this benchmark, we feel that there is sufficient transparency around the index that a Trustee should be able to manage their active risk appropriately. Accordingly, we are supportive of using this new unlisted property benchmark in the Performance Test.

The unlisted infrastructure benchmark on the other hand has not yet reached the same stage of maturity. Manager weights are not disclosed, and the index has not yet been frozen, meaning that managers can drop in and out. This can, and has historically, significantly altered the historical returns of the benchmark. The index is also only available on a quarterly basis with a meaningful lag, and when combined with APRA's current quarterly data collection/calculation process, this could create significant timing discrepancies. Given these concerns on top of this being un-investible, we believe it is not appropriate for this benchmark to be used in the Performance Test. We note that the Productivity Commission came to a similar conclusion about the maturity of this index.

We appreciate the government's responsiveness in adjusting the benchmarks to reflect the Australian investment approach more broadly and recognise this may remain a contentious topic for some time to come. Our expectation is these issues will be addressed by the index provider over time as the index matures, and it may well become suitable for inclusion in the performance test in future. This is something APRA should actively review over time. In the meantime, our preference would be for the original listed infrastructure benchmark to be used in its place.

The issues highlighted with respect to benchmarking these two unlisted asset classes are of course only the tip of the iceberg when it comes to the complexity in real world portfolios of alternative assets held by superannuation funds. These will range from high risk, high return investments to low risk, defensive assets. It is in these alternative asset classes where Trustees are most likely to be trialling innovative investment strategies which could significantly improve member outcomes through higher returns or better portfolio diversification. The nature of innovative strategies is such that there is often not a long performance history or suitable benchmark. We support the use of traditional equity and bond benchmarks, provided they are appropriately weighted to reflect the long term reasonable return objective for the asset class – as discussed previously.

With respect to the proposed Listed Infrastructure benchmark – the FTSE Core Developed Infrastructure Index hedged to AUD - our preference, like many in the industry, is for the Government to use the S&P Global Infrastructure Index instead. This preference aligns with the chosen index from the Productivity Commission report and is preferred on the basis that it is a more diversified and more representative index given the nature of typical infrastructure portfolios held by Australian superannuation funds.

## 1.5 Assessment of MySuper Lifecycle products

We are pleased to see that MySuper lifecycle products will be tested at the product level, based on the weighted average return of the combined stages. We consider the simplicity of this approach is desirable and recognises that lifecycle strategies are constructed as a single strategy (that adjusts over time with members' changing circumstances), such that the construction of each stage informs each other.

## 1.6 Data collection and performance calculation frequency

As noted in our previous submission, our preference is for APRA to move to measuring asset allocation and performance monthly. The current quarterly process can impart additional basis risk and performance outcome variability as the implementation of new SAAs on the first day of a new quarter is not recognised by APRA for three months. The impact can be material when changes are large and/or this coincides with volatile market conditions.

## 1.7 APRA methodology, discretion and review

The performance assessment design, and the regulations, have understandably favoured simplicity over complexity, however, this may lead to unintended distortion which is why it will be so important for APRA to build out its capability in understanding markets and measuring performance. APRA should have the ability to apply discretion under certain circumstances, particularly where there have been sudden, disruptive events in financial markets (see our Your Future Your Super submission to Treasury's consultation).

We further suggest that APRA review its heatmap and member outcomes framework considering the YFYS reforms to ensure greater consistency. We suggest the regulations require APRA to review the YFYS methodology within two years:

- To assess whether the measures deliver to the government's satisfaction and to consumers' needs (improving understanding of their super and moving to better performing products),
- To periodically review the investment benchmarks and methodology behind the performance test and consumer comparison tool, to ensure both are providing useful, accurate and relevant information, and
- To test the impact of APRA's discretion in implementing the performance measures.

In the context of fund mergers, another consideration should be whether APRA's powers have been sufficiently adjusted so it can flexibly assist merger processes as funds deal with varying results from performance tests.

For example, funds may need to operate two or more MySuper products in the short term until operational integration can be completed. If there is considerable variation in performance in the merging funds, we ask that APRA be able to work with the funds involved to ensure that the more successful fund's performance report is not damaged by disclosure.

Similarly, we suggest that simpler performance measures, more streamlined merger approaches and lighter touch on penalties be adopted in the event APRA requests a high performing fund to assume responsibility for an underperforming fund.

## 2. Consumer communication and comparison tool

### 2.1 Stapling and underperformance

The regulations provide guidance on ATO's criteria for selecting which account should be stapled where a person holds multiple products. They also should provide guidance for the ATO on the issue of stapling members to superannuation products which have not passed performance assessment tests. We suggest the following:

- ATO should not staple an account where the product has been excluded from receiving new members, without issuing a warning to the member, and
- ATO should advise members who are stapled to an account which has failed one performance assessment.

### 2.2 YourSuper comparison methodology

We are supportive of the increased transparency the YourSuper comparison tool could afford members and the broader public. However, there is very little information available about this tool.

We are concerned about the potential design of the comparison tool and likelihood of ongoing confusion relating to the performance test versus the comparison tool.

We consider it is essential for a measure of risk to be incorporated into the comparison tool to ensure consumers are more fully informed and able to see products appropriate to their needs.

As discussed in the previous section, this is especially important for members in the lead up to their retirement.

Based on member research and advice relationships we suggest maximum peak to trough drawdown as a measurable, objective and readily understandable risk measure. It is important that any measure of risk provided is calculated over the same horizon as the performance measure, to ensure members are informed on an apples-for-apples basis.

To counter the dilemma of one-size-fits-all performance measurements, YourSuper should help members by including and encouraging the use of filters which govern for:

- Age and expected years to retirement,
- Performance after total fees (calculated based on a members' actual balance), and
- Risk (maximum peak to trough drawdown)

In a recent *Investment Magazine* interview, our CIO commented:

"Clearly you can have two balanced or two growth funds that have got very different SAAs and their absolute returns could be very different, and so the lower absolute returning fund could be seen as the better performer in the performance test even though they've delivered much lower absolute returns to members," he said. "That goes to the issue that there's not a reference to risk and... obviously in a perfect world you'd have a reference to risk."

For lifecycle options, our preferred approach would be for the YourSuper comparison tool to filter the universe based on age / date of birth and balance so that consumers are able to easily focus in on the products that are applicable to their circumstances.

The information provided in the comparison should reflect the characteristics and investment structure of products that are currently in market. While the performance test is inherently retrospective in nature, the comparison tool is designed to facilitate product comparisons for the purpose of informing present and future fund/product selection and investment decisions. It should be more forward looking.

Simple, clear and informative member experiences are critical in building trust and encouraging members to take action. The provision of information that relates to legacy products, particularly products that have materially different risk/return characteristics, is misleading to members and likely to cause frustration and confusion. This issue might occur following a merger or where the investment strategy and or product design of a MySuper product has materially changed. A process is required for funds to work with APRA and the ATO to update product information on the comparison tool in this instance, or where it becomes apparent that incorrect information has been published on the tool.

### 2.3 Guidelines for use of the YourSuper Comparison tool

It would be helpful for trustees to have early access to the YourSuper comparison tool before its public launch. Super funds will need to train call centre staff on how to use the comparison tool, its key points and how members can use it. If funds have recently gone through mergers, they will also need to explain to members how the calculator displays their before and after merger-date performance and why it has changed.

The following items need further explanation in the regulations. We have listed these with our suggestions as to how to proceed.

About the YourSuper comparison tool	Suggested approach
Will funds be able to link to the YourSuper tool from their website or from marketing collateral?	This would be ideal, but should be optional.
<p>In the context of mergers, how will YourSuper show legacy brands, especially after a merger or SFT?</p> <ul style="list-style-type: none"> <li>• Will products be shown in the new or previous brand?</li> <li>• Will there be transition periods?</li> <li>• Will products be shown separately? For how long?</li> <li>• Will funds negotiate that directly with APRA?</li> </ul>	<p>We suggest a limited transition period, say to a maximum of two years.</p> <p>Where a fund has two or more MySuper products open during a merger transition, they should be shown separately, with APRA’s oversight.</p> <p>We note there are challenges with merged “returns” as they provide approximate returns.</p>

About the YourSuper comparison tool	Suggested approach
Will members be able to filter products by age? Or by years to retirement as appropriate for their age or risk profile?	This is particularly important for members nearing retirement who may otherwise be unwittingly nudged towards a very high growth product (designed for younger members) with little appreciation for its inherent riskiness.
How will YourSuper treat insurance?	Many members keep products open to keep specific insurance cover. YourSuper should be able to provide basic information about level and type of cover (for example, TPD \$500,000, or Income Protection \$5000 p.m.)

## 2.4 Further consideration will be required for Trustee Directed Products

Current regulations understandably focus on the imminent application to MySuper funds. However, we note that further consideration of the performance test and associated letter will be required before they are applied to Trustee Directed Products.

In some instances, member choice involves limiting the universe of potential investments, creating significant basis risk relative to the broader universe applicable to MySuper options.

Furthermore, where a member has made a choice, this should be reflected in letter, even if it is not reflected in the design of the test. Trustees should be able to reference, where appropriate, that members may have had broader objectives (than purely investment performance) when they chose the product, including:

- Their personal risk appetite,
- A focus on environmental and social issues,
- A desire to build their own portfolios, by blending different options, and/or
- To retain a product for insurance purposes.

Where a member has made a choice, this should be reflected in letter, even if it is not reflected in the design of the test.

For these reasons, we suggest that a slightly different letter apply where members have made choices.

## 2.5 Underperformance notification – trustees' responses and impact

The description of the performance test in the underperformance letter is misleading as it describes a peer relative performance comparison. This is not the nature of the SAA benchmark test which APRA will conduct. This mixing of descriptions of methodology will add to confusion if members receive the underperformance letter and then potentially find their fund is a top performer on the comparison tool (or the reverse).

The letter also needs adjusting so that it is clearly a government directed letter and does not put trustees in the position of giving advice, and should allow for members with more than one product (so they do not receive multiple letters).

As the notification letters go out, the use of comparison tools and the number of members reaching out to their funds' call centres will increase dramatically.

While this might be a second order consideration, having call centre staff swamped with calls pushes out wait times and increases members' anxiety about what will already be a difficult experience for them. Members may wish to ask about their insurance cover, whether a particular investment strategy is suitable for their age and circumstances, or for help with managing a rollover.

New staff may need to be recruited to manage the load, adding to overall costs. New and existing call centre staff will need training on what they can and can't say to members in these circumstances, and on what actions will be permitted. For example, some funds will be able to point out to members that there are other higher performing products in the offering, while others will not. Again, considerations of what is permissible as general advice will be critical at this time.

Consequently, we suggest that letters be sent out in a staged program over one to two months, depending on the size of the affected cohort, and that APRA and ASIC monitor members' experiences with receiving the notifications.

### 3. Challenges with Portfolio Holdings Disclosure

Aware Super supports the transparency objective of the Portfolio Holdings legislation, and notes that Australia lags many other jurisdictions in providing information on investments held by each investment option. However, we disagree that a **full investment listing** for each investment option is beneficial for members because:

- Most members are not advised,
- The lack of a materiality threshold means disclosure is overwhelming and less useful to consumers,
- Grouping of like-for-like investments provides clarity, and
- Protecting investment value means there are solid investment reasons why disclosing the dollar value of unlisted investments is NOT in members' best interest.

These points are expanded on below.

#### 3.1 Most members are not advised

The assumption in the Explanatory Memorandum that "most members rely on professional advisers or reports by professional investors and analysts" is incorrect. Most members are unadvised and have no access to professional reports unless they pay for them. ASIC's recent research showed that 12% of Australians had received financial advice on any topic in the previous 12 months (and 27% ever)<sup>2</sup>. Professional advisers can obtain this information directly from us and make an informed assessment without the need for public disclosure.

The disclosure needs to be useful for an *unadvised* member, or else a significant amount of education/explanation needs to be provided to the member (and the fund's service centre) about what each of the data points means and how they should interpret it. This would be particularly relevant if Option 2 were adopted, as the amount of detail on derivatives and bonds is significant and challenging for someone without a finance education.

#### 3.2 Without a materiality threshold disclosure is overwhelming

Each investment option owns a share of a sector pool, and as a large superannuation fund, we own a lot of investments and hold index funds via a mandate in most listed asset classes. Index funds hold virtually every listed investment that comprises the relevant index. A recent listing of our investments in the MySuper Growth option was over 20,000 lines (27 pages). Many of these investments are quite small, so will barely register as a holding.

A materiality threshold would be useful as the volume of investments would be overwhelming for most members to review. If investments of <1% were excluded from the report, the list of

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<sup>2</sup> <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-223mr-consumers-see-value-in-financial-advice-but-lack-of-trust-remains-an-issue/>



investments would be more meaningful, as small investments have little impact on investment performance in any case.

### 3.3 Grouping of like-for-like investments provides clarity

Rather than listing every single investment held, certain asset classes, such as cash, bonds and derivatives, would benefit from having investments grouped by name or by kind of investment item (eg. Australian Government Bond, USD forward contracts etc) and/or purpose (eg. currency hedging). Listing out every maturity date, coupon rate etc would not provide useful information for the majority of members, while the average duration as an asset class metric for bonds and cash, for example, might provide some insight. Some provision for grouping investment types would provide a more user-friendly report.

### 3.4 Protecting investment value

In addition, there are solid *investment reasons* why disclosing the dollar value of unlisted investments is NOT in members' best interests.

There are two key problems: the first is to do with publishing valuations of certain assets, particularly unlisted infrastructure assets; and the second with engaging specialist venture capital and private equity managers who are highly protective of both intellectual property and asset valuations. We believe that disclosing a range is more appropriate for unlisted investments.

- If a fund owns 100% of an asset, and publishes its value on their website, this may "anchor" the asset's value with future purchasers, as the value of the asset is there for all to see, causing the following challenges for gaining the best possible capital gain for members:
  - If we want to run a competitive sale process for that asset, publicly disclosed valuation information is not helpful for optimising the value received by members. Publishing the asset's value limits its re-sale value.
  - By extension, the same issue applies to any unlisted asset's valuation that is publicly disclosed, because during the sales process, our percentage holding of the asset becomes known to potential buyers and they can work out the current valuation from our website disclosure.
  - Limiting the sale value of an asset is clearly not in members' best interests, nor is revealing what we would pay for like-for-like assets to vendors when we want to bid on them, and these details will be available for all to see.
  - Realistically, the only people interested in this level of valuation detail would be competitors and those looking to leverage the information for their own benefit – but not our members.
- Additionally, we are likely to struggle to get access to a significant number of venture capital, Asian and top tier US private equity funds if we need to disclose the name of the investment next to its underlying value and update this regularly:
  - We have already had private equity managers reject us when the proposal to them contained a materiality / commercial-in-confidence threshold, where we would disclose

the value of an asset which represented greater than 1% of the value of an investment option (for example).

- This issue will be worse given the final regulations didn't contain any materiality or commercial-in-confidence reporting threshold which again, is hardly in the best interests of members.

We strongly suggest that assets such as private equity, unlisted infrastructure and unusual assets be reported with the assets identified, but with values grouped at asset class level, or disclosed in valuation ranges.

### 3.5 Indicative implementation costing

In terms of the questions about costings posed in the Explanatory Memorandum, our response is outlined in the table below. Whilst we have some sympathy for Option 2, overall, we think Option 1 would be more member-friendly and allow members to gain a better understanding of how their superannuation fund is invested, and do this at a lower cost, particularly if some grouping of cash, bonds and derivatives is allowable.

<b>Net Benefit Analysis – Estimated Costs and Impacts</b>		
<b>Item</b>	<b>Option 1</b>	<b>Option 2</b>
<b>INDICATIVE TOTAL</b>	\$285,000 +/- 25%	\$775,000 +/- 25%
<b>Legal costs</b>	<ul style="list-style-type: none"> <li>• Costs = \$25,000</li> <li>• Costs cover external legal advice.</li> <li>• Significant costs have already been expended over many years to negotiate with every counterparty so that this reporting will be available to us, when required, and these costs have not been included in this analysis.</li> </ul>	<ul style="list-style-type: none"> <li>• Costs = \$25,000</li> <li>• No additional cost</li> </ul>
<b>Business practices and data compilation</b>	<ul style="list-style-type: none"> <li>• Costs = c.\$200,000</li> <li>• Significant data analysis of asset structures required to determine which parts of an investment are associated and non-associated. Once identified, investments may need to be split, and somehow a value ascribed to several parts of the same investments for reporting purposes. This will require significant systems configuration, data sourcing and analysis.</li> </ul>	<ul style="list-style-type: none"> <li>• Costs = c.\$450,000</li> <li>• Data analysis of asset structures still required.</li> <li>• Manager costs similar to above.</li> <li>• System build and data extraction would require stitching data from internal data warehouse, Bloomberg and credit ratings houses – a significantly more complex process. Project BAU resourcing cost increase as a result.</li> </ul>

<b>Net Benefit Analysis – Estimated Costs and Impacts</b>		
<b>Item</b>	<b>Option 1</b>	<b>Option 2</b>
	<ul style="list-style-type: none"> <li>• Cost and time impost on underlying managers to deliver data and set up the processes to do so.</li> <li>• System build to incorporate the non-associated assets and extract the data in the required format. Data extraction &amp; reporting limited to one system.</li> <li>• Digital configuration assumed to be restricted to a webpage with PDFs.</li> <li>• Cost includes project delivery resourcing.</li> </ul>	<ul style="list-style-type: none"> <li>• Digital configuration similar.</li> <li>• Additional resourcing would be required to support complexity of delivery while maintaining current timeframes.</li> </ul>
<b>Training</b>	<ul style="list-style-type: none"> <li>• Costs = absorbed as part of BAU.</li> <li>• Training limited to those extracting the data.</li> </ul>	<ul style="list-style-type: none"> <li>• Service Centre training = c.\$5,000</li> <li>• In addition to option 2, will require Service Centre training so the different fields can be explained to members. Explanatory guide will need to be developed by change management for the website to help mitigate questions.</li> </ul>
<b>Ongoing costs</b>	<ul style="list-style-type: none"> <li>• Resourcing Costs = absorbed with BAU resourcing.</li> </ul>	<ul style="list-style-type: none"> <li>• Resourcing Costs = absorbed with BAU resourcing.</li> <li>• Third party costs are ongoing.</li> <li>• Potentially more complex to onboard new assets, extract and stitch data from different sources (custodian, Bloomberg, credit rating providers etc). May require additional resourcing to deliver this unless it can be sufficiently automated.</li> </ul>
<b>Third party costs</b>	<ul style="list-style-type: none"> <li>• Costs = \$60,000</li> <li>• Security identifiers – providers charge to publish their identifiers.</li> <li>• Look-through data - there is a vendor cost to source, validate and supply look-thru data from underlying managers.</li> <li>• Custodian costs to implement changes to data.</li> </ul>	<ul style="list-style-type: none"> <li>• Costs = \$300,000 (excluding costs to publish proprietary market data like credit ratings).</li> <li>• Bloomberg – charges for systematically storing market data characteristics that are not currently available in the internal data warehouse.</li> <li>• Moody's, Fitch and other ratings providers – charge for publishing their</li> </ul>

Net Benefit Analysis – Estimated Costs and Impacts		
Item	Option 1	Option 2
	<ul style="list-style-type: none"> <li>Implementation of data storage and validation tool for complex publishing to website.</li> </ul>	<ul style="list-style-type: none"> <li>ratings and not all investments will have ratings from one provider.</li> <li>Look-through data - there is a vendor cost to source, validate and supply look-thru data from underlying managers. Additional characteristics data increase the complexity and cost of this service.</li> <li>No additional technology implementation costs.</li> </ul>

### 3.6 Annual Member Meetings additional information timing

We support increased transparency for members and other stakeholders, and note that the proposed additional information may be helpful for members.

The regulations note that funds can provide the latest available Member Outcomes report. As APRA’s fund level data are released in Dec-Jan annually for the preceding financial year, there is a very small window of time for completing and approving the Member Outcomes report in time for publication by the final date for Annual Member Meetings, as spelled out here:

- notice of the meeting must be given not later than six months after financial year end, and the meeting held within three months after notice,
- consequently, most funds will be targeting holding meetings by 31 March of each year, and
- there is barely enough time between the publication of APRA’s fund level data, the completion of the Member Outcomes assessment and the holding of the meeting.

We therefore question the value and relevance of providing Member Outcomes reports from the previous year that are effectively more than 21 months old (for example, the Member Outcomes provided for a meeting held by 31 March 2022 could refer to performance for the financial year to 30 June 2020).

We suggest that providing the Member Outcomes report is optional and that members are advised in the Annual Member Meeting that the latest report will be available on funds’ websites and the expected date of publication.

## 4. Conclusion – regulations

The regulations provide limited additional detail on how each measure is to be implemented, in particular the account stapling and BFID measures. We noted our concerns in detail in both our submission to the Treasury in December 2020 and the Senate in March 2021.<sup>3</sup>

Our main concerns about the regulations relate to the technical details on performance assessment and portfolio holdings disclosure.

For performance assessment, we would like to see two categories of “other”, being “other growth” and “other defensive”.

For portfolio holdings disclosure, we would like to see:

- Quoting of ranges of values for unique assets,
- Grouping of like assets where the combined information provides more insight into the portfolio – especially for cash, fixed interest, and derivatives, and
- Option 1 as the required disclosure regime, given the additional costs and complexity associated with Option 2.

We recognise and support the need for a low cost, high performing superannuation and retirement system, and believe our proposed amendments help ensure superannuation works better for all Australians.

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<sup>3</sup> [https://treasury.gov.au/sites/default/files/2021-02/c2020-124304\\_aware.docx](https://treasury.gov.au/sites/default/files/2021-02/c2020-124304_aware.docx)

<https://www.aph.gov.au/DocumentStore.ashx?id=9551bc97-4580-412f-8a8a-5e97ed3d2ed2&subld=705277> and  
<https://www.aph.gov.au/DocumentStore.ashx?id=e68ab33a-d9d8-4dc8-a985-8b0ad3533319&subld=705277>