

25 May 2021

Director
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By email: superannuation@treasury.gov.au

Consultation on Your Future, Your Super Regulations and associated measures

Thank you for the opportunity to comment on the exposure draft regulations published by Treasury on 28 April 2021.

IFM Investors was established more than 25 years ago by a group of Australian industry super funds to protect and grow the retirement savings of their members by investing in nation-building infrastructure. Today, we invest across four asset classes – infrastructure, debt, listed equities and private equity – on behalf of more than 500 like-minded pension funds and other institutional investors worldwide. The \$155 billion entrusted to us by these investors incorporates the retirement savings of approximately seven million Australians and more than 30 million working people worldwide.¹

This submission follows:

- our submission to the Treasury on the Your Future, Your Super package on 23 December 2020; and
- our submission to the Senate Economics Committee on the bill on 18 March 2021.²

Our key points include:

- A CPI+X benchmark is the most appropriate for assessing the performance of investments in unlisted infrastructure and this reflects the market practice of leading institutional investors in Australia and in other jurisdictions.
- The *MSCI Australia Quarterly Private Infrastructure Index (Unfrozen) - Post-fee Total Return (All funds)* is the most appropriate existing index for unlisted infrastructure, however it is not ideal. It was not designed for regulatory purposes and certain safeguards should be established.
- The proposed approach to portfolio holdings disclosure would require the public provision of information that could compromise the ability to secure optimal outcomes for members when selling assets. Modest changes could reduce this risk.

¹ As at 31 March 2021.

² These are available at <https://treasury.gov.au/consultation/c2020-124304> and https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABYFYS/Submissions respectively.

Addressing underperformance in superannuation

As IFM Investors is not a super fund, we will not be subject to the annual performance test. However, we have an interest in a reasonable approach to benchmarking performance because the net returns that our investors receive from our products and services will be incorporated into the aggregate returns of superannuation products and compared against a composite benchmark based on each investor's asset allocation. We believe that all Australians deserve to be in a high performing super fund, and we are proud to play our part by delivering long-term performance to our investors through market-leading risk-adjusted returns net of fees.

We welcome the Government's decision to include administration fees as part of the performance test, in line with feedback from across the industry and superannuation consumers.

Infrastructure

IFM Investors is globally recognised as a leader in unlisted infrastructure investment and works closely with institutional investors around the world in respect of investment strategies for the asset class.

We appreciate the consideration provided to feedback from across the industry that a listed index is not an appropriate benchmark for unlisted infrastructure. Among other things, the previously proposed *FTSE Core Developed Infrastructure Index hedged to AUD* (the "FTSE Index") would have incentivised funds to build higher risk and less diversified portfolios with a detrimental impact on investment in Australian infrastructure and other sectors that support economic growth and deliver critical services to the community.

The draft regulations propose to benchmark unlisted Australian and international infrastructure investment performance against the *MSCI Australia Quarterly Private Infrastructure Index (Unfrozen) - Post-fee Total Return (All funds)* (the "MSCI Index").

The MSCI Index is the best off-the-shelf index currently available for unlisted infrastructure investments. Compared to the previously proposed FTSE Index, it is less volatile, better reflects the risk-return characteristics of the asset class and is more representative of Australian super funds' typical infrastructure exposures in both geography and sectors. It is also superior to other alternative unlisted indices that could have been chosen, such as *EDHEC Infra300 Index* ("EDHEC Index").

The MSCI Index, while preferred, is still not an ideal approach. Importantly, the index was developed for use by sophisticated investors for information purposes, not as a regulatory instrument. Some characteristics of the MSCI Index that could undermine its suitability for regulatory purposes include:

- Data contributions are voluntary, which can result in skewed outputs driven by selection bias. In addition, the data collection challenges are complex across variables such as fees, tax, hedging and leverage.
- The composition of the index is not fully transparent, including contributors' investment strategies.
- Many superannuation funds, especially large ones, invest directly in infrastructure and these investments cannot be included in the index under its current methodology.
- The regulations would, as a practical matter, require super funds and other entities to pay for subscriptions to the MSCI Index, under conditions in which there are no substitutes and therefore little competition regarding price or quality.

Given the above, and the wide range of infrastructure investment strategies, we still consider an absolute CPI+X benchmark to be more appropriate (noting that CPI+4% is the most commonly utilised), especially over an eight year timeframe, and this reflects the market practice of leading institutional investors in other jurisdictions.

Nevertheless, if the Government decides to proceed with the next best alternative – the MSCI Index – as proposed, it should seek to implement some safeguards – in particular, making the return series publicly available, making the methodology fully transparent, and providing assurances on management of conflicts of interest and pricing. The development of these safeguards and ongoing Index governance should include a formal role for a group of users (including superannuation funds) and infrastructure managers to have input. IFM will, as a contributor to the index, commit to working constructively with MSCI and other contributors to improve the transparency of the index and provide advice on methodological issues.

We also request that Treasury and the Government monitor the appropriateness of the benchmark as the performance test is implemented, including committing to periodic review, in consultation with industry, to ensure that it is appropriate and will not have distortionary effects on infrastructure investments by super funds.

Fixed interest

IFM Investors is one of the largest fixed income managers and non-bank lenders in the market, offering a range of income based options focusing on corporate, consumer and infrastructure debt, bond and cash strategies.

As flagged in our initial submission to Treasury, the proposed approach for benchmarking the performance of fixed interest investments does not account for floating rate investments, for which the income payment received on invested capital is adjusted based on market interest rates. This is a significant and growing part of the fixed interest market, representing as much as \$40 billion of annual bond issuance in recent years, and an option that can provide investors with improved capital protection during periods of high interest rate volatility.

For Australian fixed interest, the selected benchmark is the *Bloomberg Ausbond Composite 0+ Index*, although we note that some fixed interest strategies, particularly those relating to credit are focused on investing in floating rate structures. The same Index provider also has a floating rate benchmark – the *Bloomberg Ausbond FRN Credit Index* and we recommend this be added as a second index. Without this, funds may be disincentivised to invest on a floating rate basis even where this would provide flexibility in risk management and be beneficial to fund members from a capital preservation point of view.

Improving accountability and member outcomes: portfolio holdings disclosure

We recognise the Government's stated policy intent of increasing transparency in the superannuation system. We also welcome engagement from super fund members who would like to better understand how their retirement savings are being invested.

However, the regulations and supporting materials relating to portfolio holdings disclosure do not clearly set out the obligations for reporting different types of investments and do not provide any flexibility to account for situations in which disclosure of information would prejudice members' best financial interests or may be commercially sensitive. The portfolio holdings disclosure regime

may also have negative competitive implications by applying different standards of disclosure to different investments based on superannuation interests – this may limit the willingness of some parties to partner with, offer services to or co-invest alongside superannuation funds and their managers.

Infrastructure

In line with longstanding industry concerns, poorly designed disclosure requirements may enable the potential sale value of large unlisted assets to be determined. Sale processes may be initiated by infrastructure funds or through unsolicited offers from external parties, and providing potential buyers with this information could ultimately compromise members' returns. While the regulations appear to require funds to disclose only the valuation of their interest in an infrastructure asset, and not the percentage of an asset they own, ownership shares for some major assets are or may become public and it may be possible for market participants to gain meaningful information from such disclosures, especially where funds are direct equity owners in an asset alongside IFM's infrastructure funds and other private or government owners.

We support the recommendations that Industry Super Australia has set out in its submission, allowing either or both of two options for disclosing of the value of unlisted assets in ways that will protect the interests of members:

- allow each unlisted asset to be separately identified but provide only an aggregated value for the group of infrastructure assets, or
- allow the value for each unlisted asset to be disclosed as a range instead of a single dollar value, similar to the existing practice of AustralianSuper.

Private equity

There are similar commercial sensitivities in the potential disclosure of the valuations of companies held in private equity portfolios. Furthermore, the regulations as proposed may stop super funds getting access to top tier managers, as many managers will push back on asset level disclosure and not allow carve outs to confidentiality clauses in the fund documents.

We recommend that the regulations allow each portfolio company to be separately identified, where required under particular holding structures, but provide only an aggregated value for all private equity products held by the fund. Publication of a valuation range for each asset is not practical given the high number of potential holdings in a typical private equity portfolio.

Debt

The examples provided in the regulations and explanatory materials refer to cash and bonds, providing little guidance or specific consideration for bank loan style private debt instruments, but it appears the expectation is that funds disclose the cost and tenor of all debt and credit instruments in which they have an interest. The cost and tenor of private debt is considered highly commercially sensitive information by all borrowers, and we anticipate significant difficulties in getting cooperation to disclose such information publicly. Further, the proposed rules may put super funds at a competitive disadvantage relative to the major banks, in that borrowers may not wish to do business with funds or associated managers when it means they will be unable to keep lending information confidential.

We recommend that the regulations allow for cost and tenor to be withheld while disclosing borrower names, holdings and face value. Given that debt holdings may run to thousands of lines of

reporting, flexibility to provide only an aggregate valuation of all debt holdings would reduce the compliance burden on funds and managers and provide a more meaningful and easier to navigate form of disclosure to fund members.

Best financial interests duty

At IFM Investors, the best financial interests of superannuation and pension fund members are at the heart of our purpose, which is to protect and grow the long-term retirement savings of working people. While we agree that trustees should act in the best financial interests of members, the proposed changes to the *Superannuation Industry (Supervision) Act 1993* are not proportionate nor justified, and are likely to increase costs and legal uncertainty for trustees. In particular, the provision to allow regulations to be made to specify that certain payments or investments made by trustees of super funds are prohibited, or prohibited unless certain conditions are met, poses unacceptable risks to commercial decision-making.

We note that the Government has not released exposure draft regulations to support this schedule of the bill, providing no guidance as to its intended application of these powers and making it difficult for funds and managers to anticipate and prepare for the impact of this legislation. This also highlights that having these powers embedded in regulation rather than primary legislation limits scope for industry consultation and proper parliamentary debate.

Thank you again for the opportunity to comment. For further information, please contact Anna Engwerda-Smith, Director of Policy and Research, at anna.engwerda-smith@ifminvestors.com.

Yours sincerely

A handwritten signature in black ink that reads 'David Whiteley'. The signature is written in a cursive, flowing style.

David Whiteley
Global Head of External Relations