

31 August 2020

Treasury
Langton Cres
Parkes ACT 2600

By email to: superannuation@treasury.gov.au

Dear Treasury,

AIST Response to Superannuation Portfolio Holdings Disclosure consultation

In brief: AIST proposes specific changes to the Regulations to ensure disclosure does not prejudice members best financial interests. AIST calls for the value of unlisted assets to be disclosed within overlapping price dollar ranges and for the removal of further elements of derivative disclosure.

About AIST

The Australian Institute of Superannuation Trustees (AIST) is a not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate, and public sector superannuation funds.

As the principal advocate and peak representative body for the \$1.5 trillion profit-to-members superannuation sector, AIST play a key role in policy development and is a leading provider of research.

AIST advocates for financial wellbeing in retirement for all Australians regardless of gender, culture, education, or socio-economic background. Through leadership and excellence, AIST supports profit-to-member funds to achieve member-first outcomes and fairness across the retirement system.

Summary of concerns

If implemented in its current form, the disclosure regime will create the following adverse outcomes that will negatively impact financial outcomes for super fund members:

- Disclosing the precise value of unlisted assets will advantage foreign buyers (who aren't required to disclose specific values) over Australian superannuation funds – this may increase foreign ownership of these assets over time and jeopardise Australian jobs
- The precise disclosure makes Australian superannuation capital less attractive to investment partners and reduces access to investment opportunities
- Australian superannuation funds will be prevented from maximising the sale price when they are selling an unlisted asset as buyers will have information on the vendor's current carrying value

- Foreign buyers will have an advantage when they are bidding for other assets in the same market as those held by Australian superannuation funds as they will have a clear signal of value
- The precise value disclosure will have a negative impact on the carrying value of assets held by Australian State and Federal Governments where interests are held alongside Australian superannuation funds
- Precise disclosure may lead to opportunistic sale approaches with public/shareholder pressure to sell the asset at the disclosed value
- Under the proposed derivatives disclosure, a hedge fund would be able to use disclosed information against an Australian superannuation fund, adversely affecting pricing and returns

Background and approach

AIST appreciates the opportunity provided by the Government for additional consultation on portfolio holding disclosure and is responding to this opportunity by making a response focused on a few key points.

AIST supports portfolio holdings disclosure and a consistent regulatory framework within which this can occur (including in relation to unlisted assets and derivatives), provided it is done in a way that does not prejudice members best financial interests.

This response is intended to be read in conjunction with the submission AIST made on the Your Future Your Super Regulations and associated measures on 25 May 2021, and the 23 July 2021 letter to the Treasurer and Minister for Superannuation co-authored with the Chief Investment Officers of twelve major superannuation funds. A copy of that letter is attached – see Appendix A.

On behalf of the superannuation fund members of AIST, and following extensive consultation with them, AIST has consistently argued for a level investment playing field that enables Australian super funds to compete for the best investment return for their members. In particular, we call upon the Government to ensure the Regulations are structured so as to:

- reduce the risk of negative impacts on investment outcomes,
- not reduce access to investment opportunities, and
- not prejudice Australian superannuation funds in their dealing with other market participants or otherwise make superannuation funds less attractive as investors.

While we recognise that the Government has outlined further changes to the proposed regulations (including in relation to derivative disclosure), this submission identifies ongoing concerns with aspects of unlisted asset and derivative disclosures that are not in members best financial interests and that should be reviewed as a matter of urgency.

Requirement for value and percentage held of directly held infrastructure and property

Signalling the precise value of unlisted assets will enable overseas buyers (including sovereign wealth funds) and hedge funds to receive an unfair advantage over Australian super funds by

creating a damaging information asymmetry. This may risk co-investment opportunities and ultimately may jeopardise Australian jobs.

The proposed Regulations relating to disclosure of directly held infrastructure would create a material information asymmetry unless other investors were required to make the same disclosures. They would also create risks around Australian super funds being considered attractive partners to global investors on future investment opportunities as they would not be competing on an even footing.

The Government has recognised this as an issue for the Future Fund (see Case Study C below) and stated that *“given... that competing institutional investors in global markets are generally not subject to these requirements, there is significant value and public benefit in enabling the Future Fund Board and the Agency to compete on an even footing in global institutional investment markets”*¹. AIST notes that it would be inconsistent and harmful to the members of Australian superannuation funds for greater unlisted asset disclosure requirements to be required for their funds compared to the Future Fund.

A review of international jurisdictions also reveals that disclosure requirements for pension funds in other systems do not include obligations to disclose unlisted asset prices (see Case Study D below). These requirements are also structured to protect the interests of the members of these pension funds.

AIST supports disclosure on a wide-ranging basis but calls for it to be done in a way that does not prejudice members best financial interests.

- **The value of unlisted assets should be disclosed within overlapping price ranges**

AIST reiterate our previous proposals for the value of unlisted assets to be disclosed within price ranges. However, our proposal is modified by now proposing that the price ranges overlap.

Disclosure of unlisted assets should be on the basis of overlapping ranges, such as \$0-10m, \$5-20m, \$10-50m, \$20-100m, \$50-200m, \$100-500m, and so on. This approach provides reasonable consumer disclosure without the price-signalling that would disadvantage the competitive investment position of Australian super funds.

In contrast, mutually exclusive ranges (e.g. \$0-50m, \$50-100m, \$100-200m, \$200-500m etc.) will have the consequence of capping the potential exit values of assets with a valuation near the top of the prescribed range. For example, buyers will be anchored by the \$100m maximum for an asset that is valued at \$95m that will fall into the \$50-100m range. Under the proposed framework of overlapping values the asset can be disclosed in the \$50-200m range, and therefore not unreasonably limiting the exit value.

1

https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId:r6759%20Recstruct:billh_ome, p.23

If the Government finds merit with the proposal for overlapping ranges, AIST submits that there should be further consultation with the superannuation and investment communities about details of the ranges.

The following scenarios illustrate the problem associated with precise price signalling of unlisted assets, and not specifically considering members best interests. Case studies A and B have been received from some of the largest Australian superannuation funds.

- **Case study A – competing with a foreign competitor**

An Australian super fund owns a stake in an Australian unlisted asset (Asset A), the carrying value of which is not public information. However, another Australian unlisted asset may come onto the market (Asset B), which operates in the same industry as Asset A. If the carrying value of Asset A was disclosed this could be useful intelligence for a potential bidder in determining their bid price for Asset B.

Using that information, a foreign entity can become incrementally more comfortable in bidding aggressively for Asset B, confident that its cost of capital is lower than competing Australian super funds (as evidenced by the carrying value of Asset A).

If the foreign entity is successful in its more aggressive bid, it may become more incentivised to increase earnings through cost cutting (e.g. job cuts) than an Australian super fund would be if it had won with a lower bid price. It negatively impacts an Australian Fund trying to sell its unlisted asset if it is publicly disclosed what it is being valued for by the vendor. This could severely impact the vendor from maximising its exit opportunities as buyers will now have in their possession commercially sensitive information on the vendor's current carrying value.

Ultimately, this disadvantages members of the Australian super fund as it may not have the ability to fully maximise its sale price and achieve the best possible returns. It would also have a negative impact on the carrying value of assets held by Australian State and Federal Governments where interests are held alongside Australian pension funds.

- **Case study B - Telstra infrastructure sell down**

Telstra has recently sold down a 49% interest in its Towers business to a consortium comprising the Future Fund, Commonwealth Superannuation Corporation and a superannuation fund.

Telstra is a listed entity on the ASX and subject to continuous disclosure rules. Telstra is also a remaining owner in the towers business (51%).

Telstra would be hesitant to sell down its 49% stake to a superannuation fund who had to publicly disclose the value of its holdings in this business as any disclosure by owners of the 49% stake indirectly discloses the value of Telstra's 51% holding in the business. This value being disclosed is potentially detrimental to Telstra:

1. *On any sale of its 51% stake in the business, as the sale price may be anchored to the disclosed price, meaning Telstra may not be able to maximise its sale profits:*

2. *During the hold period, if the value disclosed is decreasing over time, it can suggest there is something negative about the asset, resulting potentially in:*
 - a) *Increased Public scrutiny of the Telstra towers business;*
 - b) *Potential challenges for the business to access third party financing at the same rates and margins; and*
 - c) *Opportunistic approaches for a purchase of the business, at a price anchored to the disclosed price which, if the approach is disclosed publicly, could result in public/shareholder pressure to sell the asset at that price.*
3. *Ongoing, it would need to review its ASX reporting strategy to ensure it is not in breach of the ASX continuous disclosure rules, given a third party is now indirectly disclosing its asset valuation.*

These potential issues would not exist if Telstra sold to a party who did not have to disclose its value, such as offshore pension/sovereign wealth funds and hedge funds or other investment managers.

It then places these parties at a competitive advantage vs Australian superannuation funds.

When institutional investors are acquiring interests in these large infrastructure and property assets, it is market practice to ensure that they buy their interests with pre-emptive rights. A pre-emptive right is a right for any existing owner of the business to buy a stake being sold by any other owner of the business, before it goes to market. This places incumbent investors at an advantage vs external third parties to increase their percentage ownership of assets.

Given these two factors, offshore pension/sovereign wealth funds and hedge funds may over time own larger and larger stakes in Australian Infrastructure and property assets. This may give offshore parties greater control of these businesses, including for example, the ability to control CEO and senior management appointments, agree budgets and business plans and target headcount number and for the offshore party to have a greater number of members on the Board of the asset. It would also include greater control over how these businesses are structured and where its operations occur, including the ability to determine if certain functions are better performed offshore.

- **Case study C – the Future Fund**

On 25 May 2021, the Government introduced legislation to give the Future Fund exemptions from freedom of information law. Under the proposed legislation², any Future Fund documents showing investing amounts, or that mentions its evaluation of potential or current investments and investment managers, would be exempt from disclosure.

2

<https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId:r6759%20Recstruct:billhome>, p.23

It is both prejudicial to the effective operation of the Australian superannuation system and inconsistent for Australia's sovereign wealth fund to be exempted *by legislation* from disclosure of matters that Australian superannuation funds are required to disclose *by regulation* of the same government. That policy initiatives with opposite intent are being pursued at the same time is particularly puzzling.

Each of the arguments put forward by the Government in the Explanatory Material to their Exposure Draft Legislation in relation to the Future Fund are directly applicable to portfolio holdings disclosure by Australian superannuation funds:

113. Item 1 would provide a partial exemption from the operation of the FOI Act for the Future Fund Board and the Agency, in relation to documents in respect of the investment activities of the Future Fund Board.

114. The Future Fund Board and the Agency regularly produce, negotiate and receive documents that include confidential, competitive and commercially sensitive information. The public release, and potential for public release, of such information could compromise the ability of the Future Fund Board and the Agency to implement investment strategies effectively on behalf of the Government. Any compromise could have a very significant impact, given the Future Fund Board manages over \$225 billion of Government assets as 31 March 2021.

115. The partial exemption from the operation of the FOI Act will reduce the risk of disclosing highly sensitive commercial and proprietary material. For example, the Future Fund Board is required by the Future Fund Act to invest through investment managers. Private equity and other investment managers place significant commercial value on their ability to operate and trade with proprietary information and in confidence. The potential risk of disclosing highly sensitive commercial and proprietary material about their activities, or proposed activities, is a risk to investment managers' effective engagement with the Future Fund Board and the Agency.

116. In some situations, this has led to the Future Fund Board and the Agency having access to less information from investment managers than they would normally expect, which presents an investment and governance risk. In particular, this presents the risk of negative impacts on investment outcomes, reduced access to investment opportunities and it could also prejudice investment managers in their dealing with other market participants. This in turn could make the Future Fund Board and the Agency less attractive to clients.

117. Given the Future Fund Board's important role in seeking to strengthen the Commonwealth's balance sheet, the growing size and complexity of the funds managed by the Future Fund Board, and that competing institutional investors in global markets are generally not subject to these requirements, there is significant value and public benefit in enabling the Future Fund Board and the Agency to compete on an even footing in global institutional investment markets.

118. The exemption in this item would be consistent with the treatment of other entities that deal regularly with commercial information. This includes NBN Co, which is exempt for documents in respect of its commercial activities and Export Finance Australia, which has an exemption for

documents including in relation to its insurance and financial services and national interest transactions.

- **Case Study D – international comparison**

A desktop assessment of several jurisdictions including the United States, Japan, the Republic of Korea, and the Netherlands shows that disclosure by large pension funds do not include disclosure of unlisted asset prices. AIST submits that the disclosure obligations of Australian superannuation funds should be comparable with those of other major pension fund systems in order to ensure ongoing competitiveness in the international investment market. Table 1 summarises these findings.

Disclosure of derivative holdings

- **Some elements of derivative disclose are only relevant to market participants**

AIST supports the removal of the requirement to disclose maturity dates and counterparty name for derivatives but submits that this should be supplemented by a further change to disclosure requirements.

Specific details on reference index/contract, strike price, tenor and notional value of the derivative are matters that individually or collectively should be removed. This would not diminish the utility of key disclosures.

The following examples provide sufficient information to members and other interested parties to enable them to understand the nature and value of the instruments disclosed without compromising a fund's position.

- Australian equity index put option, direction: short, time until expiration: >12 months, current mark to market value: \$100,000.
- US single stock equity call option, direction: long, time until expiration: 3 – 12 months, current mark to market value: \$500,000.
- AUDUSD FX forward, direction: long, time until expiration: < 1 month, current mark to market value: \$1,000,000.
- US interest rates future, direction: short, time until expiration: 1-3 months, current mark to market value: \$10,000.

Table 1: Disclosure of unlisted asset prices in other jurisdictions

Fund	Government Pension Investment Fund Japan	National Pension Service Investment Management	Stichting Pensionenfonds Abp	PGGM	New York State Common Retirement Fund
Jurisdiction	Japan	Korea	Netherlands	Netherlands	USA
FUM (USD)	\$1.69 trillion	\$729.8 billion	\$597.2 billion	\$289.9 billion	\$254.8 billion
Disclosure of individual unlisted asset prices	No	No	No	No	No
Source	https://www.gpif.go.jp/en/	https://fund.nps.or.kr/jsp/page/fund/mcs_e/mcs_e_04_07_02.jsp	https://www.abp.nl/english/investments/	https://www.pggm.nl/media/pftmayxp/pggm-investments-annual-report-2019.pdf	https://www.osc.state.ny.us/common-retirement-fund

Under the currently proposed draft Regulations, a hedge fund would be able to backout the exact specifics of the contract – information which can be used against a superannuation fund and may affect pricing and returns.

AIST submits that the removal of the specific details mentioned earlier in this section reduces the risk of adverse outcomes for members of Australian super funds.

In the alternative, the aggregation of derivatives (in addition to the changes in the current version of the draft Regulations) would be an acceptable alternative.

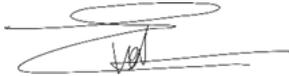
Notwithstanding this alternative, risk would still exist with the aggregation of derivatives given that the mere disclosure of positions in some instances can be gamed.

AIST contact

We look forward to discussing these comments with Treasury on Friday

Please contact AIST Senior Policy Manager David Haynes (dhaynes@aist.asn.au) if you have any questions or seek further information in the meantime.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Eva Scheerlinck', with a horizontal line underneath.

Eva Scheerlinck

Chief Executive Officer

APPENDIX A

23 July 2021

Hon Josh Frydenberg MP

Treasurer

Senator the Hon Jane Hume

Minister for Superannuation, Financial

Services and the Digital Economy

Minister for Women's Economic Security

By Email: josh.frydenberg.mp@aph.gov.au and senator.hume@aph.gov.au

Dear Treasurer and Minister Hume,

Your Future, Your Super Regulations - Portfolio Holdings Disclosure

We write to you as Chief Investment Officers who collectively invest \$826 billion dollars on behalf of the 9.6 million members of the profit-to-member superannuation funds we represent.

We support increased transparency around superannuation fund investments through Portfolio Holdings Disclosure and strongly believe members should be provided with information about where their retirement savings are invested.

However, we are concerned that the proposed Portfolio Holdings Disclosure regulations in its current form will compromise our ability to deliver the best returns for these members and leave Australian super funds at a competitive disadvantage compared to international peers.

Our concerns relate to how the regulations will impact the buying and selling of the following price-sensitive holdings:

- **Unlisted assets:** The draft regulations (together with the now legislated removal of the 5% disclosure exemption for commercially sensitive holdings) will require superannuation funds to disclose price sensitive information on unlisted assets. This will undermine our capacity to compete for these assets in a globally competitive market and compromise our ability to sell them at the best price.
- **Derivatives:** The draft regulations will also impact negatively on the member returns derived from derivative exposures. The greatest impact will be felt in over-the-counter (OTC) derivatives such as forwards, swaps and equity options where market opacity is beneficial to a fund's ability to implement positions, both in terms of price and volume terms. For example, a fund's ability to transact in the Australian OTC equity option market, which is relatively small with few large participants (compared to the US and UK markets), is

expected to be compromised if a fund is forced to disclose derivative exposures at the counterparty level. In a best-case scenario, a fund would expect its counterparties to take this into account and offer less favorable pricing and/or more limited capacity. In a worst-case scenario, it is not implausible that some counterparties may refuse to transact with a superannuation fund given the potential for other market participants to use this information against them. Reporting OTC derivatives on a lagged and/or aggregated basis will also not address these problems. Aggregating OTC derivative exposures at the reference security or market level will still allow other market participants to position themselves around superannuation fund exposures, which is standard market practice. Similarly, reporting derivative positions on a lagged basis will not help given that many OTC derivatives have maturities of greater than three months. Other market participants will be able to effectively arbitrage superannuation fund derivative positions.

Given the important role these play in delivering super fund outperformance and smoothing out market volatility, we ask the Government to consider amendments to the draft regulations to allow for:

- each unlisted asset to be separately identified with an aggregated value provided for the group; or the value for each unlisted asset to be disclosed in a range; and
- a specific removal of the requirement for funds to disclose their derivative positions.

Such amendments would not be inconsistent or at odds with the new legislative framework for Portfolio Holdings Disclosure. They would also be consistent with global best practice.

We appreciate that the registration of the Your Future Your Super regulations is imminent and would appreciate the urgent opportunity to discuss these concerns with you.

If you would like to discuss our proposal further please contact Eva Scheerlinck on 03 8677 3800 or at escheerlinck@aist.asn.au.

Yours sincerely,

Eva Scheerlinck

Chief Executive Officer

[and the Chief Investment Officers on 12 major superannuation funds]