SUBMISSION

Submission to Treasury on the *Superannuation Portfolio Holdings Disclosure: Exposure Draft Regulations*

31 August 2021

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Treasury
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Via email: superannuation@treasury.gov.au

31 August 2021

Dear Sir/Madam,

Superannuation Portfolio Holdings Disclosure: Exposure Draft Regulations

The Association of Superannuation Funds of Australia (ASFA) is writing in response to your consultation on the *Superannuation Portfolio Holdings Disclosure: Exposure Draft Regulations* (Exposure Draft Regulations) released for feedback and comment on 17 August 2021.

About ASFA

ASFA is a nonprofit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 16 million Australians with superannuation.

GENERAL COMMENTS

ASFA supports the objective of superannuation funds transparency.

It is important, however, that this is done in the best interest of fund members.

ASFA has significant concerns about the level of detail required to be disclosed under some of the provisions in the Exposure Draft Regulations, most of which were detailed in our submission to Treasury on a previous exposure draft version of the regulations in May 2021.

Application only to Australian superannuation fund trustees

The most significant issue is that the detailed disclosure of portfolio holdings only applies to the trustees of Australian superannuation funds.

The disclosure will be available to all market participants. All other investors, domestic and global, will have detailed information about the investments of Australian superannuation funds that other investors in the same market are not required to disclose.

This will place Australian superannuation fund trustees at a material disadvantage when investing.

Adverse effect on investment opportunities and returns

As a direct result of portfolio holdings disclosure Australian superannuation funds will

- be denied the opportunity to invest in particular investments, such as private equity
- no longer be able to invest directly in unlisted assets but be forced to invest through third parties
- be forced to disclose a 'reserve price' for unlisted assets, thereby reducing gains on their disposal
- disclose the price of futures contracts, which undermines the position of the fund
- disclose the amount of outstanding hedges, that may affect pricing and liquidity.

This will have an adverse effect on the investment returns to members – clearly not in their best interests.

Government legislating to exclude Future Fund from similar disclosure through information requests

We note that the Government is legislating to exclude the Future Fund from disclosing similar information in response to Freedom of Information requests.

The stated underlying policy rationale includes

- publishing details about holdings could compromise the ability to implement investment strategies
- given the Funds Under Management (FUM), any compromise could have a significant impact
- disclosing commercial information is a risk to investment managers' effective engagement – will have less access to information from investment managers than normally would expect
- there is a significant likelihood of
    - negative effects on investment outcomes
    - reduced access to investment opportunities
    - prejudicing investment managers in their dealing with other market participants
- disclosure of investments could make the disclosing investor less attractive as a client
- given
    - the growing size and complexity of the investments being managed
    - competing institutional investors in global markets generally are not subject to this disclosure

  there is significant value and public benefit in being able to compete on a level playing field.

All of these statements apply equally to Australian superannuation funds.

Given this, there is a need to ensure that superannuation portfolio holdings disclosure does not compromise the ability of superannuation funds to implement investment strategies, risk investment managers' engagement, produce negative effects on investment outcomes, reduce access to investment opportunities or make Australian superannuation funds less attractive as clients.

Competing institutional investors in global markets generally are not subject to this disclosure – Australian superannuation funds need to be able to compete on a level playing field.

To compel the trustees of Australian superannuation funds to disclose information that does not have to be disclosed by other investors represents a material distortion of the market.

SPECIFIC COMMENTS

ASFA member organisations have raised some issues about specific aspects of the Exposure Draft Regulations which are the subject of this consultation. These are outlined in the Specific Comments section of the submission.

Should you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4021 or via email to fgalbraith@superannuation.asn.au.

Yours sincerely

Fiona Galbraith
Director, Policy

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Corporations Amendment (Portfolio Holdings Disclosure) Regulations 2021 (Exposure Draft Regulations)

ASFA and our member organisations are committed to increased transparency for members of super funds.

Member organisations have indicated, however, that in some instances the requirements with respect to portfolio holdings disclosure not only will be of limited value to members but will be counterproductive.

Our member organisations have raised a number of concerns with respect to various aspects of the proposed Exposure Draft Regulations that they consider are not in the best interest of members as they will, in fact, adversely affect the investment earnings outcomes for members.

1. General observations

1.1 Principles-based approach

Member organisations have indicated that, as the portfolio holdings disclosure regime may be subject to future change, a principles-based approach should be adopted with a focus on identifying the principles that should be considered when applying any future changes to the regime.

The principles could include:

- *avoiding the revelation of commercially sensitive information* – this can produce real financial harm to members, with any benefits from transparency insufficient to offset the harm. The disclosure of derivatives and unlisted investments creates significant exposure across the industry – superannuation funds are being required to disclose this information to all other market participants
- *maximising the effectiveness of the disclosure* – information with respect to derivatives will just add substantial bulk and complexity to the disclosure (literally thousands of lines), be incomprehensible to members, lead to confusion and detract from the intent of the regime
- *minimising the cost of compliance* – it should be borne in mind that, in meeting the regulatory requirements with respect to disclosing portfolio holdings, typically superannuation funds have only one source of data – their custodian. This creates a poor dynamic with respect to competition, making the cost of complying with the regulatory requirements difficult, if not impossible, to negotiate. There will also be additional costs in responding to member queries with respect to individual positions – in particular regarding complex derivatives.

1.2 Disclosure of commercially sensitive information / breaching of confidentiality provisions

Member organisations consistently have expressed concern that aspects of the Exposure Draft Regulations will force trustees to disclose commercially sensitive market positioning and investment strategies, that will undermine future investment returns.

Importantly, aspects of the proposed disclosure will mean that superannuation trustees will be denied the opportunity to invest in particular investments, such as private equity.

Superannuation funds, as a source of long term, patient, capital, are eminently suitable to invest in unlisted assets such as infrastructure. As a result of the compulsion to disclosure valuations of unlisted assets, and the effect this will have on fellow investors in these assets, trustees will no longer be able to invest directly in these assets but instead will be forced to invest through third parties, thereby incurring additional, unwarranted, fees and costs.

Australian superannuation funds will

- be denied the opportunity to invest in particular investments, such as private equity
- no longer be able to invest directly in unlisted assets but will be forced to invest through third parties.

With respect to the stock of existing investments in unlisted assets, disclosure of certain information is likely to breach the confidentiality provisions of agreements with third parties, especially information with respect to derivatives counterparties and identifiers.

Disclosure of certain information is likely to breach confidentiality provisions in third party agreements.

1.3 Disclosure to this extent does not occur in other significant investment jurisdictions

There appears to be a perception that pension funds in other jurisdictions disclose their portfolio holdings to the degree prescribed in the Exposure Draft Regulations.

We are not aware of another significant investment jurisdiction in which pension funds are required to disclose this level of detail with respect to their portfolio holdings. The effect of the Exposure Draft Regulations will be to place Australian superannuation funds at a material disadvantage to other institutional investors when competing for investment opportunities, both in Australia and globally.

We are not aware of a significant jurisdiction where pension funds are required to disclose holding details.

1.4 Disclosure to this extent does not apply to other Australian investors

The Draft Explanatory Statement for the previous Exposure Draft version of these regulations – the *Treasury Laws Amendment (Your Future, Your Super- Improving accountability and member outcomes) Regulations 2021,* released in late April 2021 - stated the policy rationale for the portfolio holdings disclosure regulations is as follows:

> *A more transparent superannuation system will help people see how their contributions are invested with **all market participants** having access to adequate information about the **overall investment market**. Reforms, such as improved **superannuation** portfolio holdings disclosure (PHD), are needed in Australia to improve our systemic transparency. ...*
>
> *Transparency supports the efficiency and operation of a compulsory, market-based savings system. It improves **understanding, awareness and engagement at various levels**. Government intervention to secure a high level of transparency will allow **more informed decision making** and enhance **confidence and competition in the superannuation system** (emphasis added).*[1]

Superannuation portfolio holdings disclosure nominally is about disclosure for the benefit of members of superannuation funds.

The sheer volume and level of data to be disclosed is unlikely to be useful to member, and generally this is not the type of information that members will utilise when making decisions about their super funds.

More importantly, however, is the fact that the disclosure is available to **all market participants.**

All other investors in Australian and around the world – who are investing in the same markets as Australian superannuation trustees – will have access to information about the investments of Australian superannuation funds **that these other investors do not have to disclose. This places Australian superannuation fund trustees at a material disadvantage when investing.**

Disclosure is available to **all market participants.**

All other investors will have information about Australian super funds **that they do not have to disclose.**

This will place Australian superannuation fund trustees at a material disadvantage when investing.

1.5 Government legislating to exclude Future Fund from similar disclosure through FOIs

On 25 August 2021 the Government introduced the *Investment Funds Legislation Amendment Bill 2021* into the House of Representatives.

Schedule 2 of the Bill provides a partial exemption from the operation of the *Freedom of Information Act 1982* for the Future Fund in relation to the investment activities of the Future Fund.

[1] Draft Explanatory Statement for Exposure Draft version of *Treasury Laws Amendment (Your Future, Your Super- Improving accountability and member outcomes) Regulations 2021, April 2021, Page 2*

The Explanatory Memorandum provides the policy rationale for this exemption from disclosure as follows:

> 114. *The Future Fund… [has] confidential, competitive and commercially sensitive information.* ***The public release****, and potential for public release,* ***of such information could compromise the[ir] ability****…* ***to implement investment strategies effectively****… . Any compromise could have a very significant impact, given the Future Fund… manages over $225 billion of Government assets as at 31 March 2021.*
>
> *115. The partial exemption… will* ***reduce the risk of disclosing highly sensitive commercial and proprietary material****. … 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****… is a* ***risk to investment managers' effective engagement*** *with the Future Fund… .*
>
> *116. In some situations, this has led to the Future Fund …* ***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 … [a] less attractive client****.*
>
> *117. Given the … growing size and complexity of the funds managed by the Future Fund …, 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 … 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 (emphasis added).*[2]

Publishing some holdings details could compromise the ability of funds to implement investment strategies. Given APRA regulated funds manage over $2.2 trillion, any compromise could have a significant impact.

Disclosing commercial information is a risk to investment managers' effective engagement with funds. Funds will have less access to information from investment managers than they would expect normally.

There is a risk of

- negative impacts on investment outcomes
- reduced access to investment opportunities
- prejudicing investment managers in their dealing with other market participants

This in turn could make Australian superannuation funds less attractive clients.

Given

- the growing size and complexity of the investments managed by funds
- competing institutional investors in global markets generally are not subject to these requirements

there is significant value and public benefit in funds being able to compete on a level playing field.

1.6 Concepts in Exposure Draft Explanatory Statement not in Exposure Draft Regulations

There are a number of concepts in the Exposure Draft Explanatory Statement that are not contained in the Exposure Draft Regulations themselves.

By way of example some of these include the definitions of percentage weighting and valuation methodology, whether trustees should disclose book value or enterprise value, and some issues with respect to the application of this regime to 'associated entities' and where the 'look through' test stops, to determine what assets are disclosed.

[2] Explanatory Memorandum to the *Investment Funds Legislation Amendment Bill 2021, Page 23*

This lack of specificity is not ideal and will mean that super fund trustees will be reliant on regulatory guidance as to what it means to comply with the regulatory requirements. Given this uncertainty there are likely to be different approaches to the implementation of some of the detail of the requirements.

1.7 Asset classes – align with APRA and ASIC reporting

Members have observed that it would provide for increased efficiency, and significantly lower administration costs, if the asset classes for portfolio holdings disclosure were aligned with the asset classes that are used for reporting to APRA.

Members have suggested that, in an effort to drive efficiencies and reduce cost in the system, consideration should be given to the ability to source data from existing sources.

ASIC Derivates Transaction Rules Reporting currently has Over the Counter (OTC) Derivatives reported and is expected to be expanded to cover Exchange Traded Derivatives from late next year, at which time all derivative data will be available at a portfolio / fund level. Portfolio holdings disclosure largely requires the same data to be reported but in a different manner.

Accordingly, consideration could be given to portfolio holdings being disclosed on the same basis as the corresponding data is reported to the regulators.

2. Specific comments

2.1 Unlisted assets – single valuation will prejudice returns to members

With respect to unlisted assets, including private equity and infrastructure, the requirement to publicly disclose a single valuation to the market, akin to a 'reserve price', will serve to dampen the market process for disposals and thereby limit the gain that can be realised on sale.

Further, the requirement to also disclose the percentage ownership, in addition to the market value, is detrimental from a competition perspective.

In addition, as confidentiality is vital to other investors and investment managers, any requirement for a superannuation fund trustee to disclose a valuation will operate to exclude superannuation funds from future investment opportunities. Often private equity funds do not permit investors to make disclosures about their investment, so if super funds trustees are compelled to disclose details about their private equity investments this means they will be excluded from future opportunities to invest in private equity.

The proposed disclosure will work against maximising the yield on assets and have a significant detrimental effect on the return on investments, which is not in the best interests of the members of super fund.

Disclosure of a single valuation for unlisted assets will also make it more difficult to procure valuations. Valuations are procured from independent valuers and are performed on the basis that they are confidential. Given the inexact nature of unlisted assets valuations, if there is to be public disclosure of a single valuation, independent valuers may be less willing to provide a valuation.

Recommendation 1

The holding valuation of unlisted assets either should be disclosed as a range or bundled with similar assets.

2.2 Derivatives and hedging contracts – price information

Members have welcomed the removal of the requirement to disclose maturity dates and the names of counterparties name for derivatives and hedging contracts.

There remains, however, considerable concern with respect to the level of granularity of the proposed disclosure and that the requirement to disclose other attributes would still enable sophisticated investors to recreate the funds' positions and take advantage of this knowledge. Portfolio holdings disclosure should not be required in a way that adversely affects commercial considerations or which discloses 'commercial in confidence' or commercially sensitive information.

In particular, member organisations have queried the benefit to members of providing the strike price of futures contracts, as disclosure of this information may pose a risk. By way of example, in the case of foreign exchange (FX) forwards or options, funds will need to disclose the contract price – disclosure of the strike price may undermine the position of the fund as often these contracts are rolled forward or rebalanced via liquidity providers.

Members have raised some significant concerns that disclosure of the aggregate size of outstanding hedges has the potential for significant market impact. Disclosure of the amount risks alerting the market to the size and direction of exposures that may affect pricing and liquidity and ultimately disadvantage superannuation funds, especially with respect to less liquid derivatives.

Recommendation 2

The price of futures contracts and size of outstanding hedges should not be disclosed.

2.3 Derivates – aggregation

Members have identified that the disclosure requirements are inconsistent with other jurisdictions, such as the UK, where exposures are reported only in aggregate and not on a 'case by case' basis.

Within any particular investment option there may be hundreds, or even thousands, of derivatives, the disclosure of which would extend over multiple pages/screens and be of little or no benefit to members. Information with respect to each derivative will just add substantial bulk and complexity to the disclosure, be incomprehensible to members, lead to confusion and detract from the intent of the regime

In order to maximise the effectiveness of the disclosure consideration could be given to adopting an approach whereby derivatives of the same kind could be aggregated.

Recommendation 3

Consideration could be given an approach where derivatives of the same kind are able to be aggregated.

2.4 Derivatives – asset classes

Members have observed that APRA requires reporting of derivatives is based on the value of the exposure to the relevant asset class sector to which they relate.

Given the additional level of detail and data required to be disclosed for derivatives under portfolio holdings disclosure, these could not easily be reported as part of the related asset classes. Accordingly, this means that asset class value reported for portfolio holdings disclosure and APRA reporting will not align.

2.5 Fixed income – maturity dates and coupon values

For fixed income assets, member organisations have queried the value of disclosing additional detail, such as the maturity dates and coupon values.

Members have also raised concerns that having to disclose the coupon values of fixed income securities may cause them to breach confidentiality obligations with issuers, and consider that this requirement should be removed.

Recommendation 4

For fixed income assets, the disclosure of the maturity dates and coupon values should be removed.

2.6 Cash and bank bills

Members have queried the underlying intent behind the splitting out of 'cash' and 'bank bills' as separate items in the revised draft regulations.

They have suggested alignment with APRA reporting, where 'cash' is defined as representing cash on hand, and demand deposits, as well as cash equivalents – ordinarily this would include bank bills, treasury bills, and commercial paper. If this approach is not adopted, clarification will be required as to how treasury bills and commercial paper should be reported for the purposes of portfolio holdings disclosure – as cash or bank bills.

Recommendation 5

'Cash' and 'bank bills' should be aligned with APRA reporting.

Members have suggested that, with respect to cash, the heading should be 'units held or face value' as units would not always be appropriate for cash holdings.

Recommendation 6

For cash, the heading should be 'units held or face value'.

2.7 'Other' and 'commodities' – replace with 'alternatives' and 'FX exposure'

Members have noted that APRA has changed the asset class sector classifications for *SRS 550 Asset Allocation* to replace 'other' and 'commodities' with 'alternatives' and 'FX Exposure', which generally are more closely aligned to the classifications used in Product Disclosure Statements (PDS).

Given this, we recommend that the portfolio holdings disclosure tables also use these classifications.

Recommendation 7

The disclosure tables should use 'alternatives' and 'FX exposure' instead of 'others' and 'commodities'.

2.8 Equity, property, infrastructure and commodities – units as well as value and percentage weight

With respect to equity, property (unitised), infrastructure (unitised) and commodities (unitised) members have queried the requirement to display the number of units held as well as the value and the percentage weight, as it creates unnecessary complexity but does not really add any value.

Members have expressed the view that the value and the percentage weight should be sufficient to achieve transparency, without having to disclose the number of units held as well.

2.9 Direct property – physical address

Members have queried the requirement to disclose the physical address for direct property to add transparency and have identified the risk that the property may be subject to public protests that are directed at the fund but will adversely affect the tenant(s).