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Superannuation Portfolio Holdings Disclosure: Consultation on Draft Regulations

AustralianSuper welcomes the opportunity to make a submission in response to draft regulations released by the Minister on 18 August 2021 (draft regulations).

AustralianSuper previously made a submission in relation to the portfolio holdings disclosure (PHD) requirements announced as part of the Your Future Your Super package on 27 May 2021 and we reiterate the points made in that submission.

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. Almost 2.5 million Australians are members of AustralianSuper and we invest over \$230bn of their retirement savings on their behalf. Our purpose is to help members achieve their best financial position in retirement. We are proud to be the nation's top performing superannuation fund over the past 7, 10, 15 and 20 years (to 30 June 2021). AustralianSuper is a patient long term investor and to this end we seek outcomes that create or enhance companies' value over the longer term. This approach accords with our obligation to act in the best financial interests of members.

One aspect of AustralianSuper's strategy has been to internalise aspects of our investment activity and invest directly rather than through intermediaries. This approach delivers direct benefits to members through improved performance, increased efficiency and reduced cost. Between FY14 and FY21 this program realized approximately \$3.9 billion in total benefits for AustralianSuper members including investment cost savings of over \$570 million while delivering top investment performance on behalf of member.

Commitment to transparency in members' best financial interests

AustralianSuper is committed to acting transparently where this is in the best financial interests of members. Since 2016 the Fund has voluntarily and extensively disclosed portfolio holdings to the public on our website, where possible on a look through basis. This approach exceeds requirements for disclosure in the Corporations Act 2001.

In determining the appropriate level of transparency and disclosure AustralianSuper balances:

- Members' interests in ensuring members are provided with information about how their retirement savings are invested; and
- Our obligation to act in members' best financial interests by ensuring the Fund can create and extract value for members by actively investing to grow members' retirement savings.

This means that in some limited circumstances all information is not made available where the information is commercial in confidence or subject to contractual confidentiality obligations, where disclosure would limit the Fund's ability to create and extract value for members.

Summary - Draft regulations not in members' best financial interests

Despite amendments to the regulations originally released, the draft regulations do not strike an appropriate balance between transparency and protecting members' best financial interests.

The draft regulations:

- Will decrease returns and increase cost for members, two outcomes contrary to members' best financial interests, the Minister's stated policy intent and the Government's stated desire to reduce costs in Australia's superannuation system.
- Will not provide members with simple, accessible data to support their understanding and engagement with their superannuation. The draft regulations will require members to download and decipher tens of thousands of lines of data.
- Will advantage market competitors who are not subject to the same disclosure and will use the information for their own financial gain, at the cost of financial outcomes of members, and therefore contrary to members' financial interests.

Given these outcomes it is incumbent on Government to demonstrate the provision of data in the form required by the draft regulations will not be used to compromise the value of Australians' retirement savings prior to any new disclosure requirements being finalised.

Draft regulations not global best practice

AustralianSuper is confident our current approach to PHD represents best practice because we strike the right balance in members' best financial interests.

We note the Government's characterisation of the draft regulations as 'global best practice'. We have reviewed the regulatory models applying to the asset classes and geographies we invest in and we have been unable to identify any similar approaches in those jurisdictions. For example, in no jurisdiction can we identify a regulatory obligation requiring an institutional investor to publicly disclose the valuation and percentage holding of its direct investment into a privately held infrastructure or property asset. Our findings are that most disclosure is voluntary, rather than compulsory, and most disclosure is not complete, across private markets and derivatives.

Member feedback on appropriate levels of disclosure

The draft regulations will not meet the stated needs of the vast majority of AustralianSuper members.

In July 2021 over 15,000 AustralianSuper members participated in an online survey which included questions around awareness and preference for disclosure of portfolio holdings information. The results demonstrate that, where AustralianSuper members are engaged and aware of the Fund's PHD, the Fund is clearly meeting member needs. If any adjustments were required, member feedback points to further simplification of the information and material to support member understanding, rather than the additional detail proposed by the draft regulations.

The results indicate:

- Only 3 in 10 of the Fund's most engaged members (classified as those who have made an active investment choice) are aware of the Fund's PHD.

- Of those members who have accessed the Fund's PHD reporting, AustralianSuper's current PHD 'meets the needs of' 9/10 of those members';
 - Almost 90% of pension members felt the level of information was 'about right';
 - Over 80% of engaged accumulation members said the level of information was 'about right';
 - Around 70% of members invested in the Balanced option (the Fund's default) said the information was 'about right';
 - Almost 20% of members invested in the Balanced option said the Fund's disclosure was too detailed.
- The survey strongly indicated that the amount of information AustralianSuper makes available to members through our public PHD could be summarised or streamlined further.

The Government has not released any consumer data indicating that additional PHD detail is something superannuation fund members want. Further, given the draft regulations do not strike the right balance in members' best financial interests, any market research conducted by the Government should ensure superannuation fund members are aware of the potential implications on members' costs and returns as a result of additional disclosure.

We would be happy to provide additional information to Government about feedback from AustralianSuper members regarding the Fund's PHD.

Unlisted Infrastructure and Property disclosure

The draft regulations require disclosure of the exact value and percentage holdings in the Fund's directly held property and infrastructure assets. The draft regulations are not in the interests of members because disclosing the percentage holding and holding value of these assets is commercially sensitive information of a confidential nature that has commercial value that would be reduced if the information was disclosed. In turn, it would reduce the value of members' retirement savings, including at the point of the sale of the asset when the Fund must realise maximum possible value to ensure we meet our regulatory and trustee obligations to members.

By way of simple analogy, if someone were to sell their house, they do not disclose the value of the property prior to sale, as it may limit their ability to maximise sale proceeds. The same logic applies when AustralianSuper seeks to sell any of the direct property or infrastructure assets it holds on behalf of members.

Current voluntary disclosures appropriate

- The information required to be disclosed by the draft regulations is not already in the public domain. At the present time, AustralianSuper discloses a value range for these assets 90 days after 30 June and 31 December. This reporting aligns with the Fund's Valuation Policy and the existing APRA Regulations on asset valuations of unlisted assets.
- In our submission the disclosure of a value range in this timeframe is appropriate.

Advantaging competitors contrary to members best financial interests

- Ensuring the value of an asset remains confidential is integral to AustralianSuper's purpose of helping members achieve their best financial position in retirement. In order for AustralianSuper to sell a property or infrastructure asset for profit, it is important that the value at which

AustralianSuper holds the asset remains confidential because if this information is disclosed, a potential buyer will know the lower bound sale price and will anchor their price to this value.

- Concerningly, the draft regulations do not apply to competitors in these assets including for example, the Future Fund, offshore pension funds, Investment Banks and Private Equity Firms. As these parties will not be required to disclose this information, the draft regulations will place AustralianSuper and members (as well as other superannuation funds and members) at a disadvantage. This will create a mismatch of market equality contrary to members' interests and directly contradicts the stated policy rationale for the draft regulations.

Impact on third party investors

- AustralianSuper's assessment of an asset's value is not disclosed or known outside the Fund and would not be known even by AustralianSuper's co-investors in the same asset.

For example, AustralianSuper invests in Westconnex alongside Transurban, CPPIB and the State of NSW. While the Fund currently discloses a valuation range for its holding in this asset, and internally we know the % holding of the other shareholders, what we do not know is what each of them value their stake in the business and they do not know how AustralianSuper values our share. Knowledge of AustralianSuper's holding value on Westconnex will create price discovery opportunities for competitors.

- This is not a theoretical concern. The NSW Government is currently in the process of undertaking a public auction of its stake in Westconnex. Under the draft regulations, the ability of the NSW Government to maximise its sale proceeds would be compromised as the potential value of their stake would be disclosed to the market via AustralianSuper's disclosures.
- Another example is Perth Airport where AustralianSuper owns a small minority stake directly alongside other investors. The Future Fund and Utilities Trust of Australia are the two largest shareholders. Under the draft regulations, disclosure of AustralianSuper's minority interest value would have a greater effect on larger shareholders. Any sale price they seek to achieve will be anchored to AustralianSuper's valuation and may reduce their ability to maximise the sale price.

Reduced ability to partner to invest in significant assets, including state infrastructure

- Given the large amount of capital required to invest into infrastructure, the pool of potential investors is relatively small and the value of information required to be disclosed under the draft regulations is high. If the value is known:
 - Any potential purchasers of AustralianSuper's stake in the asset will anchor their price to what is publicly disclosed as a result of the draft regulations.
 - AustralianSuper will be prevented from accessing opportunities on behalf of members, as co-investors would not want to partner with us, given the value of their holdings will also be indirectly disclosed.

For example, AustralianSuper invests in Airport X alongside Company A and Company B, which are not superannuation funds and are not required to disclose the value of their holding. Company A is looking to sell its share. Potential purchasers will look to AustralianSuper's value to set the price for Company A's stake. This means AustralianSuper's disclosure materially impact the ability for all co-investors in the asset to maximise their sale price.

- If AustralianSuper cannot directly access these opportunities as a result of the draft regulations, the Fund will need to explore other investment methods at a substantially higher cost, which will ultimately be borne by members.
- Further, from a source of capital perspective, it will mean that Australian superannuation funds are at a disadvantage versus their investor peers, likely leading to more direct investment by offshore investors including private equity funds, pension funds and sovereign wealth funds.

Impact on investee companies

- The disclosure of the value AustralianSuper holds its assets at may also affect the economic performance of the underlying company and potentially expose the directors of that company to additional liability.
- This will occur where:
 - The lenders to the underlying company will look to AustralianSuper's valuation as a comparison point to their own view of the business. This will be particularly detrimental during a refinancing process and directly affect the debt pricing and interest rate, resulting in increased cost to the company;
 - The competitive position of the company would be compromised if over time there is a decrease in the values disclosed, making it more challenging for the company to execute on its strategy. This is particularly true when the Fund invests in smaller private companies.
For example, AustralianSuper invests alongside an affordable housing provider into a platform to develop and provide affordable housing. As this strategy is being developed, the strategy is not yet financially stable. Pending on the state of the market, having to declare valuations could potentially undermine its success as it could discourage investment and or market confidence. While AustralianSuper would be able to ride this out, its affordable housing provider would not which would generate a negative outcome when considered within the broader national context.
 - Similarly, company directors may be personally exposed to liability if AustralianSuper's values decreased over time and they did not correlate to the valuation held by the company.

Broader consequences

- AustralianSuper currently has \$8.4 billion of equity directly invested in major infrastructure projects around Australia.
- In addition to the adverse consequences for members outlined above, the draft regulations will limit not only AustralianSuper's capacity to partner on significant projects to create value for members, but will reduce the amount of available capital in the market, including for state governments, to fund projects, including major projects of benefit to Australian communities.

Unlisted Infrastructure and Property - recommended approach

AustralianSuper recommends the draft regulations be amended to:

- Only require valuation ranges be disclosed, rather than the exact value;
- Valuation ranges be in dollar values, not percentages; and
- Funds can determine valuation ranges appropriate to the nature of the assets they hold, rather than ranges being prescribed. AustralianSuper's current ranges used for PHD are available on the AustralianSuper website.

Private equity

AustralianSuper invests into private equity largely through and alongside funds managed by a General Partner (GP). Like unlisted infrastructure and property, private equity is a private market asset where company valuations are kept highly confidential. GPs place significant commercial value on their ability to operate and trade with proprietary information and in confidence.

Under the draft regulations:

- AustralianSuper may lose access to private equity opportunities, be prevented from investing in new private equity funds or to “re-up” and invest further funds with existing GPs;
- AustralianSuper would lose access to co-investment opportunities alongside GPs, which are traditionally invested in single asset holding vehicles, meaning the underlying valuation of the investee company would be disclosed. Co-investments are a benefit to members as they are at lower cost vs private equity funds.
- GPs would not be able to sell assets at the highest price, meaning returns to members would be lower.
- GPs would be incredibly reluctant to involve AustralianSuper in their funds as they do not want the value of their underlying investments known, as it would be indirectly disclosed through these proposed disclosure requirements, placing AustralianSuper members at a disadvantage.
- Disclosing the underlying valuations of GP’s funds and co-invest vehicles would reduce their competitive advantage when trying to exit/sell the investment for the reasons outlined elsewhere in this submission.

We also note that competing institutional investors in global markets are generally not subject to these requirements and the draft regulations would put at risk the significant value and member benefit in enabling superannuation funds like AustralianSuper to compete on an even footing in global institutional investment markets.

AustralianSuper is committed to helping build the Australian economy and private equity is a key lever for the Fund to invest in small Australian businesses via funds managed by venture capital (VC) and growth capital GPs and in co-investments alongside those funds.

Currently, AustralianSuper’s VC managers do not allow us to disclose any information relating to their portfolio companies, including names. Regulations requiring the Fund to disclose names and market values of co-investments would likely result in VC managers not partnering with AustralianSuper, limiting our opportunity to invest in or alongside them, resulting in detrimental outcomes for members and the broader economy.

Private equity – recommended approach

AustralianSuper recommends the draft regulations be amended to:

- Ensure private equity is not captured in the ‘other’ group of assets;
- Permit Funds to identify the fund or vehicle name for each private equity investment; and
- Provide an aggregate value for a group of private equity investments, grouped into appropriate buckets (for instance, Australian private equity and international private equity).

Derivatives disclosure

AustralianSuper currently amalgamates some of its public disclosure of derivative positions with cash holdings as part of our PHD.

Derivatives help AustralianSuper efficiently target our desired position in asset classes such as currencies, bonds and shares. Derivatives such as futures are used to quickly and efficiently gain exposure to a particular asset or asset class, these markets are deeper and more liquid than the

markets for physical stocks or bonds. They benefit the portfolio by maintaining investment exposure in a cost-effective way and can also help to manage investment risk and enhance returns.

The draft regulations will require disclosure of very specific, technical detail in relation to derivatives that will be meaningless to all but the most sophisticated member with an advanced understanding of financial markets. Set out below is a summary:

Portfolio Holdings Information for Investment – Derivatives	
Type	Fields Required
Futures	Bought / sold position; Number of contracts; Amount per contract; Price in contract (underlying); Notional amount; Currency of contract; Value (AUD); Weight (%)
Forwards	Bought / sold position; Amount; Price in contract (underlying); Notional amount; Currency of contract; Counterparty credit rating; Value (AUD); Weighting (%)
Options	Bought / sold position; Option type; Number of contracts; Currency of contract; Notional amount; Exercise price; Counterparty credit rating; Value (AUD); Weighting (%)
Swaps	Amount; Price in contract; Floating benchmark (if applicable); Notional amount; Currency of contract; Counterparty credit rating; Value (AUD); Weighting (%)

This disclosure will not be in the best financial interests of members for two reasons. First, the level of detail and complexity will be impenetrable to only but a small number of superannuation fund members:

- To comply with the draft regulations AustralianSuper would be required to publish around 21,780 lines of transaction data (based on current holdings). Given each webpage currently hosts disclosure of 20 assets, this would require an additional 1,088 webpages of disclosure.
- The disclosure will create confusion and complexity in that it does not consider only one side will be required to be disclosed creating confusion where full visibility of each of the individual transactions is not provided.
- The fact that some derivatives transactions are a hedge against other parts of the portfolio, adding confusion to the purpose of particular transactions as disclosed. For example, an AUD/USD currency forward is used as a hedge against (for instance) a USD equity investment. When the AUD/USD exchange rate falls, the value of the currency forward will fall, but the USD equity investment rises (in AUD terms). Disclosing the value of derivatives in isolation does not allow members to see both sides of this currency movement.

Second, given the confusion and complexity likely to be created for members as a result of the draft regulations, the likely entities that would benefit from the disclosure would be other derivatives traders (such as investment banks commercial banks, hedge funds, asset managers) and provide them with a competitive market advantage, including to allow them to front-run¹ our position based on our disclosure. This would lead to a reduced return for our members which is an outcome not in the interests of AustralianSuper members.

- Investment decisions can be heavily persuaded by an understanding of market positioning. With full access to our derivative positions, other market participants can alter their behaviour in response to our holdings. The disclosures required by the draft regulations would provide 'signals' to market participants that the Fund has or is likely to make certain investment decision in the near past or future.
- For example, our ability to get competitive each way prices will be highly compromised if our counterparties already know which direction and rough size of the trade we need to price.

¹ Front-running is trading stock or any other financial asset by a broker who has inside knowledge of a future transaction that is about to affect its price substantially. A broker may also front-run based on insider knowledge that their firm is about to issue a buy or sell recommendation to clients that will almost certainly affect the price of an asset.

- Traders in the futures markets will be able to position themselves with the knowledge that we have a large futures positions (eg ASX SPI 200 Futures) to roll prior to expiry deadline. Use of this information will negatively impact the trading costs and therefore returns for our members.
- For Swaps, disclosing the price dealt to competing counterparties / banks will compromise our competitive negotiating positioning. Overall, our working relationships with brokers and counterparties would be compromised.

The recent civil proceedings brought by ASIC against Westpac alleging insider trading and unconscionable conduct in relation to executing an interest rate swap are a timely reminder of the importance of preserving market integrity.

Derivatives – recommended approach

AustralianSuper recommends the draft regulations be:

- Reviewed by relevant regulators responsible for oversight of derivative markets and their advice be released as part of the current consultation;
- Amended to:
 - Allow for disclosure by logical groupings into derivative type (for instance, all forwards, all futures, all swaps, all options);
 - Report an aggregate value for each derivative type; and
 - Allow for disclosure in a member-friendly format, both in terms of the complexity and volume of information, so that it helps members engage with and understand their superannuation.

We would welcome the opportunity to work with Treasury, Government and the industry to develop a set of portfolio holdings disclosure rules that genuinely operate in the interests of Australians. If you have any further questions please do not hesitate to contact either myself (sadams@australiansuper.com) or Alistair Barker, Head of Total Portfolio Management, (abarker@australiansuper.com).

Yours sincerely



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