Superannuation Portfolio Holdings Disclosure Consultation

August 2021

ABOUT US

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system. During its start up phase, Super Consumers has partnered with CHOICE to deliver support services. Set up by consumers for consumers, CHOICE is the leading consumer advocate that provides Australians with information and advice, free from commercial bias.

Introduction

Superannuation belongs to consumers. People should have transparency about how funds invest their money.

A portfolio holdings disclosure regime in Australia is well and truly overdue. Disclosure obligations had been recommended and supported in principle by the government, following the *Stronger Super* review back in 2009.[1] These rules have been deferred in 2014, 2015, 2016, 2017, 2019 and 2020. These postponements mean the industry has had years to prepare for greater disclosure requirements and raise concerns. They have not advanced any arguments persuasive enough to override the case for greater transparency.

The current regulations provide sufficient detail for registrable super entities to comply with their obligations as set out in *Corporations Act s.1017BB.* Funds currently have relief from these requirements under *Class Order 14/443*.

With the greater clarity in these regulations around the parameters of disclosure, funds will have no excuse for non-compliance, and the regulator with responsibility for enforcing this legislation (The Australian Securities and Investments Commission [ASIC]) will be able to enforce these rules.

Recommendation 1

The portfolio holdings disclosure regulations should be introduced by the Minister as soon as possible.

Benefits of transparency

An obligation on super funds to disclose their investments has benefits on two primary levels. Firstly, consumers benefit from greater transparency around how funds invest their money. Secondly, there are benefits to systemic transparency. Third parties can assess super fund performance and strategy more effectively when they can see how the fund invests.

Australia's current levels of transparency around how super funds invest are lagging far behind international best practice. A 2020 report by financial services firm Morningstar ranked 26 global markets in a 'disclosure scorecard' based on the experiences of mutual fund investors. The report ranked the countries into five tiers: 'Top', 'Above Average', 'Average', 'Below Average' and 'Poor'. Australia was the only market in the 'Poor' category'.[2]

Portfolio holdings disclosure and ethical super

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[1] *Stronger Super - Government Response* https://treasury.gov.au/sites/default/files/2019-10/stronger_super.pdf
[2] 'Morningstar's Global Study of Fund Disclosures Finds India and the United States Earn Top Marks While Australia Continues to Lag Amid Rising Standards', *Newswire.CA*
https://www.newswire.ca/news-releases/morningstar-s-global-study-of-fund-disclosures-finds-india-and-the-united-states-earn-top-marks-while-australia-continues-to-lag-amid-rising-standards-828047278.html

Just as food manufacturers are obliged to disclose their ingredients so consumers and third party experts can make informed decisions, super funds should have to disclose their investments.

Super fund members may want to avoid their fund investing in the shares of specific companies and or particular industries. They may want to filter out any investment in companies with gender imbalances on their board, direct their investment towards innovative sectors or exclude companies who have committed environmental law breaches. Without a mandated disclosure regime, consumers cannot have confidence their fund is investing in line with their wishes.

Since the *Stronger Super Review* recommended portfolio holdings disclosure, there has been a surge in interest in responsible investment. This trend makes disclosure more relevant as consumers need a way to look 'under the bonnet' of funds and products that promote themselves as sustainable, responsible or ethical.

Previous research by Super Consumers Australia found several super funds promoting the ethical credentials of their products but not disclosing their investments or making selective and limited disclosure.[3] Consumers may be willing to pay more in fees for these products (presumably on the basis that a more labour-intensive screening process is necessary), making it more important that these products are true to label.

Under the status quo, there is a possibility of 'greenwashing' in super products. The Australian Securities and Investment Commission (ASIC) is currently researching whether this practice is prevalent across super and managed funds, which will provide a snapshot of the issue.[4] Going forward, if this market is to operate effectively consumers need to be armed with quality information about a fund's underlying investments, so they can assess its ethical claims. This will also help ensure they are getting what they pay for from funds that trade on their ethical credentials.

Systemic transparency

By facilitating greater transparency, the regulations can improve the operation of the superannuation market. Research has found mandatory portfolio holdings disclosure "could lead to the market reaping the benefits of a more efficient and effective funds management industry".[5]

Portfolio Holdings Disclosure (PHD) will facilitate regulators and researchers in better understanding the relative (under)performance of funds. It will also allow deeper investigation of the factors that go into good fund performance which can be used to assist industry and

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[3] 'Why ethical super funds can hide where they put your money', *CHOICE,* *https://www.choice.com.au/money/financial-planning-and-investing/superannuation/articles/ethical-super-disclosure-laws-delayed*
[4] Armor, Cathay 'What is "greenwashing" and what are its potential threats?', *ASIC,* *https://asic.gov.au/about-asic/news-centre/articles/what-is-greenwashing-and-what-are-its-potential-threats/*
[5] Chen, Z, Gallagher, D and Lee, A. 'Testing the effect of portfolio holdings disclosure in an environment absent of mandatory disclosure,

ultimately consumers with better performing funds. For example, PHD could allow a more informed assessment of whether funds are achieving portfolio diversity, what level of risk each fund is taking on in its investments, whether the fund is invested in any stranded assets and how its portfolio measures up against an ESG framework. There is now a body of evidence that ESG can be a useful investment analysis tool, but such external analysis of a fund's portfolio is only possible where there is disclosure.

The New Zealand experience

The experience of New Zealand before and after its heightened transparency obligations for mutual funds supports this conclusion. An academic study found "some significant improvement and no evidence (of) a negative impact" in the two-year periods on either side of the regulatory change. The authors concluded the disclosure obligations "may well have contributed to the rapid inflow of invested dollars into KiwiSaver funds."[6]

Unlisted assets

The regulations will significantly improve disclosure around unlisted assets. Requiring funds to disclose the value of these assets could also help address a market inefficiency where the same asset may be valued differently by different owners. This could lead, for example, to a super fund overpaying for an asset and getting lesser returns based on an inaccurate valuation..

Some funds voluntarily disclose the value of the unlisted assets they invest in, albeit across a very broad range. Stating an asset is valued somewhere between $300 million and $1.5 billion or somewhere below $100 million.[7] This level of abstraction is nowhere near detailed enough to be helpful to an analyst seeking to understand the relative value of an investment and the risk it might carry relative to the rest of the portfolio. The new requirement to disclose the value of each unlisted asset investment will allow a much fuller picture of how the fund invests within each asset class and external analysis of this data should boost understanding of the system as a whole.

Industry lobby groups have argued that disclosure of unlisted asset values may lower the sale prices of these assets and ultimately cause detriment to fund members.[8] However, some real estate investment trusts have been disclosing the value of the property they invest in on a biannual basis and this practice has not appeared to depress prices, with some assets selling above their listed value. Numerous global markets require pension funds to disclose their unlisted asset holdings. Those arguing against the disclosure requirements around unlisted

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[6] Cooper, James M. and Gregory-Allen, R 'Mutual Fund Performance and the Impact of Superannuation and Financial Regulation', *The International Journal of Banking and Finance,* Vol. 13, No. 2, 2017, pp.1-20 http://www.e-journal.uum.edu.my/index.php/ijbf/article/view/8503/1441

[7] Example: https://cdn.rest.com.au/rest_web/media/documents/investments/super-investment-option/balanced.pdf?_ga=2.266457486.1617477862.1629855250-695583193.1627952614

[8] *AIST submission to Treasury: Your Future Your Super regulations and associated measures,* https://treasury.gov.au/sites/default/files/2021-08/c2021-162375_aist.pdf

assets have not demonstrated that disclosure obligations in other such markets have led to sold investments at suboptimal prices.

In the absence of compelling evidence that disclosing unlisted asset valuations would cause consumer harm, the default should be for funds to fully report these investments.

<u>Derivative instrument investments</u>

The regulations set out new requirements for super funds to disclose any derivative instrument investments they hold. These instruments are essentially contracts whose value depends on the financial performance of an underlying entity, such as an equity, index or commodity.

The regulations won't require funds to disclose the counterparty name or maturity date of the derivative instrument investments they hold. While there is a hypothetical possibility sophisticated investors could use disclosed data on these investments to gain financial advantage and disadvantage the fund, it is difficult to quantify this risk. Further, it is not clear that such activity would significantly impact the value of these investments for super funds or that, by extension, this disclosure would hurt fund members.

The non-disclosure of counterparty and maturity date will make it harder for analysts to gauge the risk level of these investments. This concern is partially mitigated by the regulations requiring the fund to disclose the risk rating of the counterparty for each investment, but remains an imperfect solution.

The superannuation industry has form when it comes to mislabelling risk on its products. For example, HOSTPlus has often been criticised in the past for offering a 'balanced' product which had over 90% exposure to equities.[9] The Standard Risk Measure has been recognised by some in the industry as an inappropriate measure of risk. These factors do not inspire confidence that the industry will appropriately disclose levels of risk associated with derivatives.

Recommendation 2

That Treasury undertake a further investigation of the role of derivatives and their disclosure in financial markets. Without a more detailed review, it is possible funds could use these investments to hide significant risk and game risk assessments.

<u>Disclosure must be searchable to have utility</u>

A super fund may invest in hundreds or thousands of different securities. The sheer volume of investments in this context means that to be useful for analysts, researchers, and engaged consumers, funds should disclose their holdings in an easily searchable way instead of using a

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[9] Mather, Joanna "'Balanced' Hostplus fund's risky weighting exposed by APRA, *The Australian Financial Review,* https://www.afr.com/companies/financial-services/hostplus-has-93pc-growth-allocation-apra-20191216-p53kaw

‘data dump’ approach. The proposed requirement for funds to provide this information in an easily downloadable and delimited file format is a useful means to this end.

Similarly, allowing funds to aggregate their cash and bank bill investments by institution is a sensible measure to avoid overly onerous reporting requirements while still providing meaningful information through disclosure.

The regulations represent a meaningful improvement on the status quo

While some opaque aspects will remain even under a fully implemented portfolio holdings disclosure regime, funds retain the discretion to offer their members further information about the underlying assets of their investments. Australian Super and REST are examples of super funds which have voluntarily published more information about their portfolio holdings than legally required for some time.

The regulations have clear benefits for consumers and systemic transparency and bring Australia in line with global standards. The international experience of portfolio holdings disclosure has not produced any evidence of consumer detriment.