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Australian Custodial Services Association - Submission on the Consultation Process – Better regulation and governance, enhanced transparency and improved competition in superannuation ("the Discussion Paper")

The Australian Custodial Services Association ("ACSA") is the peak industry body representing members of Australia's custodial and investment administration sector. Collectively, the members of ACSA hold securities and investments in excess of AUD$2.3 trillion in value in custody and under administration. Members of ACSA include National Australia Bank Asset Servicing, JP Morgan, HSBC, State Street, RBC Investor Services, BNP Paribas, Citi Transaction Services and Northern Trust.

This submission is intended to provide Treasury with the collective views of ACSA members on the issues raised by the Discussion Paper "Better regulation and governance, enhanced transparency and improved competition in superannuation" (referred to as the Discussion Paper in this letter) released on 28 November 2013.

Custodians are likely to be indirectly impacted by various aspects raised in the Discussion Paper (e.g. Choice product dashboards, net investment return versus net return, measuring investment risk and liquidity), however where the Discussion paper poses questions to comment on policy options, ACSA has chosen not to respond and to instead allow our Superannuation and Fund Manager clients to provide responses, either directly or through their respective industry bodies.

This response is focused on the Portfolio Holdings Disclosure aspect of the Discussion Paper, where despite not being the regulated party, custodians are the source of record and so is anticipating being the primary producer of the Portfolio Holdings Disclosure reporting on behalf of our clients. As such, custodians are uniquely placed to have the best understanding of the operational complexity and implications of the policy questions raised with respect to the implementation and ongoing support of Portfolio Holdings Disclosure reporting.

From our ongoing discussions during 2013 and 2014 with representatives from APRA on their reporting requirements, ACSA has unearthed a number of practical difficulties in implementing the wide ranging and high level report definitions. This complexity, has in turn necessitated the thorough examination of the intended regulatory outcome in order to ensure that and the reporting provided achieves the required outcome.

As the major providers of custody and administration reporting for the Financial services industry, it is essential to ensure Custodians are able to support the desired outcome prior to the commencement of core system builds to ensure that the required reporting that is supplied to our Superannuation clients, and indeed in some instances for Fund Managers.

ACSA anticipates a similar need for a detailed review with representatives from Treasury on the proposed Portfolio Holdings Disclosure reporting and would welcome further opportunities to ensure there is a common understanding of the Portfolio Holdings Disclosure reporting requirements and how they apply across various complex operating investment structures.

We would like to thank Treasury for the opportunity to reply to the Discussion Paper and provide our response for consideration.

Regards

David Braga

ACSA Chairman

Focus Questions

20. *Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs?*

ACSA is of the view that whilst neither of the two alternative models presented by Treasury in the Discussion Paper are optimal, the "Partial Look-Through" based on the APRA reporting best aligns with our understanding of Treasury's desired policy outcome.

ACSA recommends that Treasury adopt Partial Look-Through because it is the most cost effective, has the least complicated requirements (provided there is alignment of the methodology with APRA reporting, such as applying the consistent classification of underlying security types), and is most likely to be able to be implemented for the 1 July 2014 start date and reportable within a 90 calendar day period by our respective clients. However, as it can be argued that Partial Look-Through may not provide Members with a sufficient level of transparency in relation to their indirect holdings of their Superannuation Funds, ACSA would recommend that Treasury conduct consumer testing over an 18 month period to determine the efficacy of the partial-look through model in providing members and professional advisers with useful information to assist with their decision making processes.

If consumer testing produces evidence that a Partial look-through approach does not provide adequate and useful information, ACSA would recommend a new alternative of aligning Portfolio Holdings Disclosure to the look-through reporting requirement contained in the APRA *Superannuation Reporting Standards*[1].

Look-through reporting in APRA's data collection is where information about the underlying investment in an investment vehicle must be reported. This involves looking through cascading trusts to the first non-associated entity and reporting the ultimate asset class in which the investment is held.[2]

APRA requires RSE's to report look-through data utilising a Bottom-Up Approach. The Bottom-Up Approach involves the classification of each individual security within an investment vehicle. Individual securities that have the same classification are then aggregated for reporting purposes. [3]

As Managers of Collective Investment Vehicles ("Fund Managers") are already under an obligation to provide detailed security information to their RSE clients to enable them to comply with the Superannuation Reporting Standards, there would effectively be no significant additional obligations placed on either RSE's or Fund Managers to comply with an APRA-aligned Portfolio Holdings Disclosure regime.

[1] http://www.apra.gov.au/Super/ReportingFramework/Pages/Final-reporting-standards-for-Superannuation-June-2013.aspx
[2] http://www.apra.gov.au/Super/ReportingFramework/Pages/Reporting-Framework-Frequently-Asked-Questions.aspx#faq30
[3] http://www.apra.gov.au/Super/ReportingFramework/Pages/Reporting-Framework-Frequently-Asked-Questions.aspx#faq71

Furthermore, alignment to APRA Look-Through, in requiring the disclosure of detailed security level data, would be superior in terms of improved transparency than the preferred Alternative Option 2.

Any alignment with APRA Look-Through would also be more beneficial than the posed Alternative Option 1, as data representing indirectly held securities provided by Fund Managers would be aggregated with the direct holdings of the RSE and published collectively on an RSE's website, thereby providing members with easy-to-access portfolio information, whilst also protecting the intellectual property of the Fund Managers.

It is important to note that the above comments are based on comprehensive alignment to the APRA reporting. Any deviation to the alignment would substantially increase the implementation complexity, costs and timeframes, including a need to then reconcile between the APRA and Portfolio Holdings Disclosure reporting to understand any differences and ensure that these are explainable.

This alignment would need to contemplate at a minimum the following:

1. The definition of a 'holding'

   Whilst it may seem obvious – and for on-market investments such as equities it is, however there are a wide range of assets that need to be considered such as derivatives, collateral, tax receivables, deferred tax assets, foreign exchange.

   The method for public disclosure also needs to be contemplated as not all assets have a holding that can be represented as a number of 'shares' / 'units' or a price that can be reflected as a 'price per share' or 'price per unit'.

2. Using the same data classification as prescribed by APRA under the new Superannuation regime

   APRA has devised its own asset classification approach to align underlying assets to aggregate sectors that in APRA's considered view allow it to have the appropriate level of supervisory insight into a fund. These sector classifications are recognised as being different in their consideration and treatment of assets to those classifications generally used by RSEs in considering their investment approach, portfolio construction and management

3. Using the same reporting methodology

   There is considerable complexity in how different asset types such as derivatives and foreign exchange holdings are reflected in the APRA holdings reporting. Complex fund of fund investment structures also need to be accommodated.

   This approach for Portfolio Holdings Disclosure is only viable if every methodology choice is maintained with the same outcome as that agreed with APRA.

ACSA would welcome the opportunity to meet with Treasury to explain the above points; including using worked examples if that would be of assistance.

In addition to the above items, consideration will still need to be given to how to best provide the information to members as it will still be a significant amount of data for many Superannuation Funds and

in some instances this will be expensive to maintain and standards for archiving this data should be contemplated.

ACSA would also like to raise for consideration a variation to either option regarding associated entities.

From the knowledge of our different client's structures, ACSA believes it would be appropriate to allow a RSE the choice of whether they publish the holdings for a related entity or whether they look-through related entities and publish an aggregated form.

This is because some large fund-of-fund entities would have deep structures and are likely to be less sensitive about public disclosure of the structures (so are expected to find publishing publicly their related entities the easiest response and it would achieve the same outcome). Whereas other funds with direct investments and some nominal use of associated entities may prefer to look-through and not publish the details of their associated entities.

Either way would achieve the public disclosure obligation and allows the RSE flexibility in its implementation approach to achieve the best outcome for their situation.

If there is any deviation from the APRA methodology, then ACSA's view would switch and we would strongly advocate moving forward with Option 1, where each entity publishes its own directly held holdings only and it is up to the end consumer to build any form of consolidated 'look through'.

In considering this question, you may wish to consider the various options discussed above:

- *Should portfolio holdings disclosure be consistent with the current legislative requirements (that is, full look through to the final asset, including investments held by collective investment vehicles)?*

  ACSA is of the view that full recursive look-through to the final financial product or property cannot be justified in light of the likely excessive compliance costs associated with building the relevant systems and processes to drill down into complicated investment structures involving multiple layers and are many instances off shore. The concerns expressed by various Industry Participants in previous rounds of consultation concerning the inability to enforce disclosure against foreign fund managers, as well as concerns with the disclosure of commercially sensitive information, continue to exist.

  The sheer volume of the resultant reporting is likely to be in the thousands or tens of thousands of lines and as such would also appear to be at odds with the desired outcome and lead to a substantial risk of form over substance.

  In addition, ACSA wants to bring to Treasury's attention that we are not aware of any other jurisdiction that requires this degree of full recursive look-through. This means that the level of data complexity in sourcing and merging this degree of data has not been contemplated.

- *Should the managers/responsible entities of collective investment vehicles be required to disclose their assets separately? To give effect to this requirement, legislation would require all collective investment vehicles to disclose their asset holdings, regardless of whether some of its units are held by a superannuation fund.*

Since the previous round of consultation, the APRA reporting has continued to take shape as we the Custodians and other administrators, embark on the first phase of implementation. The model of Portfolio Holdings Disclosure contemplated by this question is still viable, however does not take the opportunity to leverage the work that has already been done within the industry to achieve a more fulsome level of disclosure.

In ACSA's view, the following issues would still need to be addressed in the implementation of a model with all parties disclosing their assets separately:

(a) An obligation to disclose funds on segregated basis would effectively expose the investment strategies of Fund Managers, thereby destroying their intellectual property and any competitive advantage they may have.

(b) Without any exception for commercially sensitive assets such as property or illiquid assets, Fund managers would effectively be forced in revealing asset prices that in turn would reduce any bargaining power associated with dealing in those assets, which in turn may reduce their ability to maximise profits, ultimately to the detriment of their Supreanunation clients.

(c) As any disclosure obligation could not be enforced against foreign domiciled Fund Managers, such a disclosure obligation would position domestic fund managers in a relative competitive disadvantage *vis-a-vis* foreign domiciled fund managers. Furthermore this could be an incentive for Fund Managers to contemplate foreign domiciled structures in order to avoid the legislative requirement for Australian domiciled Fund Managers to provide Superannuation Funds with this level of disclosure i.e., details of their underlying security positions of a portfolio they are managing.

(d) How the different reporting timelines (APRA 28 Calendar Days, Portfolio Holdings Disclosure 90 days) are contemplated in terms of which information is incorporated, especially in light of Section 29QC's obligation that all reporting is based on the same methodology.

- *Should portfolio holdings disclosure be limited to the information required to be provided to APRA under Reporting Standard SRS 532.0 Investment Exposure Concentrations?*

  ACSA is of the view that any disclosure should not be limited to the reporting of investment exposures. While the detailing of large exposures would be of some use to members and professional advisers in understanding what countries and asset classes different funds are exposed to, such information lacks the degree of granularity for it to be sufficiently useful in assisting members and Professional Advisers in their decision making process. For example, the lack of security level information will be of no use to a Member who wishes to know in what companies their Superannuation Funds have invested.

  We support the idea of materiality that SRS 532.0 introduces and have commented on that in the appropriate part of this submission

21. What would be the compliance costs associated with each of these models for portfolio holdings disclosure?

There are outstanding questions with the first model around the detail of its implementation.

For example, in how assets are classified and whether this classification needs to be in line with a common standard across the industry, or whether each Fund Manager can describe their investment vehicle in whatever way they chose. A second example would be the treatment of derivatives within an investment vehicle.

As such, the compliance costs for model one are heavily reliant on the outcome of further detail and how close or divergent the results of that further work are to current reporting standards.

Upfront and ongoing compliance costs are significantly reduced by the second model as this detailed work has already been performed. It would reasonably be expected that there are limited upfront expenses as the industry has already substantially built the reporting suites to cater for this reporting. The only variation may be to allow for a filter on the Portfolio Holdings Disclosure reporting for materiality or other purposes. In addition the ongoing work to load, run and verify the reports is already catered for and it would be expected that the Portfolio Holdings Disclosure would not substantially impact this effort.

However this assumption only holds if the core reporting methodology is retained with no exceptions (similar to our response to question 20). If there are any variations to the methodology, that will add to the compliance costs on both an up-front and ongoing basis. No estimate can be provided of these costs until the size and scale of any variation is known.

22. Should portfolio holdings information be presented on an entity level or at a product (investment option) level?

ACSA recommends that Portfolio Holdings Disclosure information be disclosed at both an entity and and Investment Option level i.e., My Super and Choice Options. Entity level data provides members with information in their decision making process for determining the most appropriate fund to invest in whereas Option level data would allow the member to choose between various investment options.

Consideration also needs to be given to 'Member Direct' style models which are becoming prevalent in the market. ACSA does not believe there is any meaningful way to disclose these assets and any public disclosure is meaningless in any event as the individual member has made their own investment decision, so is fully aware of the contents of their personal portfolio.

23. Is a materiality threshold an appropriate feature of portfolio holdings disclosure?

ACSA strongly recommends a materiality threshold for Portfolio Holdings Disclosure reporting.

The initial generation of APRA reporting for the 30 September and 31 December 2013 quarter ends demonstrate that even with a limited and incremental approach to partial look-through, that most Superannuation funds are generating thousands or tens of thousands of lines of data. Whilst this is acceptable for the purposes of regulatory supervision, it is arguable that this level of detail is excessive and overly complicated for public disclosure purposes (whether to consumer (members) or the general public).

ACSA proposes a 10% materiality threshold as a pragmatic balance of public disclosure and appropriate detail. i.e. assets need to be reported that make up 90% of an Option's value.

ACSA also suggests there should also be consideration given to a minimum asset line valuation that is disclosed, for example assets that contribute less than 1 basis point to the value of the Option do not have to be reported.

ACSA notes the ability for ASIC to provide relief for RSE's, for example to protect confidential information. Notwithstanding this potential for an RSE to request specific relief, knowing the nature of our client's investments, it would be easier to provide consistency across the industry in our reporting and methodology if there were clear guidelines that allowed for treatment against common scenarios that would trigger relief (for example confidential information). This could be provided in the policy framework or via class orders.

ACSA notes that lack of consistency would likely result in manual and bespoke reporting that leads to higher compliance costs and the potential for errors or omissions.

In our view, a materiality threshold designed as described above would achieve a good balance of meaningful reporting and practical considerations around delivery of the reports.

24. What is the impact of a materiality threshold on systemic transparency in superannuation fund asset allocation?

ACSA sees this as a question for our clients and as such will not be providing a response.

25. What would be the most appropriate way to implement a materiality threshold?

ACSA would suggest a threshold is applied at the direct holdings (after look-through of associated entities) with indirect holdings then only supplied for investments within the threshold. Any direct investments underneath the threshold would be described as "OTHER" and no look through would be supplied on investments underneath the threshold.

All direct holdings whose cumulative value adds up to the materiality threshold would be included in the reporting. i.e. 90% based on ACSA's proposal of a 10% threshold

The commerciality filter (as proposed above) would then be applied and the RSE could redact individual lines up to a further threshold (ACSA's proposal 10%). These lines would have to be redacted in a way which maintained the commercial confidence of the data. For example, simply tagging a line "Property" and continuing to show the value may not be sufficient to hide the information as it may be well known what property investments has are owned by an RSE, and therefore the end reader could infer the specific property in question and its associated value.

26. Should the commencement date for portfolio holdings disclosure be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?

The ability for custodians to provide core reporting services for 1 July 2014 is totally reliant on maintaining the underlying methodology for Portfolio Holdings Disclosure as identical in every respect to the APRA reporting or to a lesser extent as per Option 2 in the Discussion Paper.

Any deviation would require analysis and development with technology work and testing. The financial year end is a core existing pressure point for Custodians providing administrative services to their clients. For many Custodians, key systems are generally put through a 'change freeze' to ensure stability of the production environment. Most of these freezes come into effect from 1 June. As such, any changes required for Portfolio Holdings Disclosure would have to be implemented prior to 1 June to be effective from 1 July.

It is not so much a question of cost as a pragmatic recognition that delivery execution of any variation would not be possible between now (mid-February and 1 July).Any attempt to retain 1 July and make changes to the core reporting already developed could result in unforeseen delivery issues of this reporting requirement or other critical services.

It is important to note that in addition to the current new APRA Superannuation reports that are live for the financial year ending 30 June 2014, that additional complex quarterly and annual reports come into play on 1 July 2014. As such, much attention is given to these system builds and on going testing to ensure Custodians are ready to support their Superannuation clients for these forms.

There still is a degree of uncertainty surrounding the remaining APRA Superannuation Forms that ACSA members continue to work through with representatives from ARPA. This ongoing consultation is required to ensure we have interpreted these reporting requirements in line with the intended outcome. This means that existing staff capacity is already dedicated and assumed to be utilized for this existing known purpose. Any additional scope or requirements will not be able to be accommodated for delivery to a 1 July 2014 timeline.

Given the ongoing two year phased implementation of the Superannuation Reporting regime, Custodians could only support a 1 July 2014 implementation for reporting that is identical to current APRA reporting or to a lesser extent, such as Option 2 in the Discussion Paper.

Any deviation could only be implemented at a later date; however such a date would be reliant on the scale of the deviation. ACSA strongly endorses a movement of the implementation date to at least 1 July 2015.