Law Council
OF AUSTRALIA

Improved superannuation transparency consultation

The Treasury

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

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Executive Summary

The Law Council welcomes the opportunity to provide comments on the consultation package "Improved Superannuation Transparency".

With regard to the proposed product dashboard reforms:

- Most funds will likely require a longer transition period – for example, 12 months from when the requirements are finalised.
- Clarification is required as to whether funds only need to prepare a maximum of 10 dashboards (plus a MySuper dashboard, if applicable), or 10 dashboards for each sub-plan within the fund.
- If it is intended for 10 dashboards to be prepared for each sub-plan, funds should be permitted to aggregate (or use a shared dashboard) for investment options offered within the same fund which are substantially identical for practical purposes.
- We are troubled by the proposed prohibition against including non-mandatory information in the dashboard. Given the concerns that certain types of data proposed to be included in dashboards could be misleading and deceptive, funds should be permitted to include clarifying information in their dashboards to ensure that their members are not misled.
- We reiterate previously expressed concerns regarding particular components of the dashboard – for example, return target, the standard risk classifications (which focus on frequency of negative returns while ignoring the magnitude of those negative returns) and the focus on net returns as opposed to net investment returns.
- Compelling funds to publish a return target defined by reference to inflation is problematic for options that do not in actual fact target returns which exceed inflation.
- If strategic asset allocation information is to be included, it is important for the associated tolerance ranges to be included.

With regard to the portfolio holdings disclosure reforms:

- We endorse the proposed removal of the look-through requirements and the shift towards making disclosure on an option-by-option basis rather than on a whole-of-fund basis.
- We are still concerned that these requirements will give rise to voluminous disclosure that is unlikely to be utilised by the majority of members, comprising (in some cases) lists with many thousands of entries for assets which are represented only at the second or third decimal point. We suggest that further consideration be given to using the power to declare a materiality threshold – for example, limiting disclosure to the top few hundred holdings or to holdings that represent more than, say, 0.5% of an option's assets.
- We suggest that portfolio holdings disclosure should be aligned with the dashboard requirements so that disclosure is only required for the 10 largest options.
- Disclosure should be permitted on an aggregated basis where a fund offers the same option to different sections of its membership.
- The 5% exemption will be too low to be of real utility for very small investment options (assuming they will be subject to the portfolio holdings disclosure requirements).

Introduction

1. The Law Council of Australia welcomes the opportunity to provide comment on the:

   - Superannuation Legislation Amendment (Transparency Measures) Bill 2015: Product dashboards and
   - Superannuation Legislation Amendment (Transparency Measures) Regulation 2015
   - *Product Dashboard Comparison Metric Consultation Paper* (Dec 2015)

2. This submission has been prepared by the Law Council of Australia's Superannuation Committee (the Committee), which is a committee of the Legal Practice Section of the Law Council of Australia. The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

3. The Law Council of Australia is the national peak body for the legal profession, representing some 60,000 legal practitioners nationwide. Further information about the Law Council is at Attachment A.

Product dashboards

Longer transition period required

4. The consultation materials assert that the proposed amendments 'will significantly reduce compliance costs on the industry'.

5. However, this depends on the reference point.

6. It is correct that the proposed amendments would alleviate the burdens that would have resulted from the legislation as originally enacted.

7. However, those provisions have never commenced operation. As such, the amended legislation still represents a substantial compliance burden for industry. We gather that the amended legislation would take effect on 1 July 2016. In our opinion, it would be a challenge for many superannuation funds to meet that deadline, especially given that the content requirements for dashboards are yet to be finalised.

8. The new dashboard content requirements are substantially different from the requirements that currently apply to MySuper dashboards, so funds would need to overhaul the dashboards which are already in place for their MySuper products. Additionally, it could be expected to take some time for superannuation estimators to be developed and tested.

9. We suggest that a longer transition of 12 months should be allowed for after the content requirements have been finalised.

Clarify definition of qualifying investment option

10. The amendments are not entirely clear as to whether a fund must have a dashboard for:

    - the 10 largest of its investment options; or
    - the 10 largest investment options within each choice product.

11. This is because it is not clear whether each sub-plan or benefit design within a fund is a discrete choice product. This should be clarified. Many funds will be under the impression that they only will only be required to have a maximum of 11 dashboards (i.e. the MySuper dashboard plus 10 others).

12. However, if a fund has, say, 5 sub-plans or 5 choice products (as defined – i.e. 5 classes of beneficial interest), it will be required to have 51 dashboards.

13. This is a critical detail that needs to be clarified, particularly given the need to provide a link to the product's PDS, which may not be publicly available.

14. Assuming that each sub-plan or benefit design is a choice product; it is quite common for funds to offer the same choice of investment options to different sections of their membership. For all intents and purposes, they are the same investment option, but for technical reasons (e.g. they are offered to different sections of the membership representing separate sub-plans and/or governed by a separate division of the trust deed) they may be separate investment options pertaining to separate choice products (as defined).

15. Clarification should be provided as to whether funds can (or should) aggregate investment options that in practical terms, are the same investment option. Aggregation would affect the number of dashboards required, and it could also affect which investment options have dashboards – depending on whether or not aggregation is permitted, the composition of the list of the 10 largest investment options may be different.

16. Even if aggregation is not permitted, at the very least, the legislation or the regulations should make it clear that a fund can use the same dashboard for multiple investment options that, in practical terms, are the same option. For example, if the fund has a High Growth Option for each of its 5 sub-plans that are largely identical, the fund should be able to use the same dashboard for each High Growth Option.

Exception where trustee has no discretion

17. Draft regulation 7.9.07M would exempt a fund from having to publish a dashboard for an investment option if the trustee does not have absolute discretion to vary or replace the financial products and other property allocated to the investment option.

18. As drafted, many funds could take the view that a large number of their options are exempt from the dashboard requirements. For example, it is common for the documentation governing unlisted investments and private equity investments to include restrictions and prohibitions on divestment. Similarly, some banks are offering more competitive interest rates on cash deposits (in light of Basel requirements) if the trustee agrees not to withdraw the deposits except where specifically directed by a member. In all of these cases, the trustee does not have absolute discretion to vary or replace 100% of the financial products and property

allocated to the investment option and would arguably be exempt from the dashboard requirements. In the first example a solution might be to amend the wording of the draft regulation to refer to the trustee not having absolute discretion to vary or replace the financial products and other property *without recourse to the member.* However the second example would remain exempt.

Prohibition against including non-mandatory details

19. We are troubled by the prohibition against including non-mandatory information within dashboards. Although non-mandatory information can be alluded to via hyperlink or hover-text, members would not necessarily see this. Further, when printed out by members, the additional information may be lost.

20. There are good reasons why funds would want to include non-mandatory information in their dashboards. Several components of the dashboard (which are existing requirements for MySuper dashboards) are unpopular within industry and are considered misleading and deceptive. For example, the definitions of 'return target' and standard risk categories are widely considered to be misconceived and likely to mislead members. The use of net returns (as opposed to net investment returns) is also contentious, because of the misleading portrayal of dollar-based fees when converted into a percentage for members with a low assumed balance of $50,000. Further, the proposed new requirement to include strategic asset allocation is potentially misleading unless the permitted tolerance range is also published.

21. It is our strong view that funds should be permitted to manage the risk of complaints and claims being made against them based on documentation that they were compelled to publish. Freedom to include further explanatory details about the limitations of the dashboard is essential in this regard.

22. ASIC's published position is that product issuers cannot rely on exculpatory text that is not given appropriate prominence. In our view it is not fair for funds to be limited to hovertext and hyperlinks to other web pages, as this would fall short of ASIC's general position on the matter.

Comments on specific components of the dashboard

23. We reiterate the widely expressed concerns regarding the use of the 'return target', standard risk classification methodology (i.e. focussing on the number of negative years in a 20 year period, without considering the magnitude of the negative years) and the use of net returns as opposed to net investment returns.

24. If strategic asset allocation information is to be included in dashboards, it is essential that the tolerance or deviation ranges also be included in order to provide a fair sense of how members' assets have actually been invested.

25. The prescribed table in draft regulation 7.9.07N suggests that the dashboard must describe an investment option's return target by reference to inflation. Leaving aside our objection to the return target methodology (which focuses on the return which funds have a mere 50% probability of achieving), this requirement would be completely misleading for options which do not (in a factual sense) aim to beat inflation. The requirements need to have sufficient flexibility to cater for investment options that have an investment objective which is not linked to inflation.

26. We note that the prescribed table contemplates administration fees and advice fees being disclosed only in dollar terms. We query whether this is a typographical error

and whether the intention is for these fees to be converted into a percentage for a member with a $50,000 balance.

27. The prescribed table requires a statement of the 10-year average actual return. However, draft regulation 7.9.07Q suggests that, for options that have been in existence for fewer than 10 years, the dashboard must include the average return for however many whole financial years the relevant option has been in existence. There should be flexibility to tailor the wording in the dashboard if it is not actually a 10 year average.

28. We cannot comment on the proposed requirement to include a 'superannuation estimator' because insufficient information has been released as to what would be involved.

Portfolio holdings disclosure

Removal of look-through disclosure

29. The proposal to remove the look-through requirements for non-associated entities will substantially alleviate the burden for funds and we endorse this aspect of the reform.

30. We suggest that the syntax of draft clause 1017BB(4) should be reviewed. The opening words of sub-paragraph (4) do not seem to match up with the various sub-paragraphs which follow. Perhaps it is as simple as deleting the word "if" from those opening words.

31. We are still concerned, however, that these requirements will give rise to voluminous disclosure that is unlikely to be utilised by the majority of members, comprising (in some cases) lists with many thousands of entries for assets which are represented only at the second or third decimal point.

Disclosure for individual investment options

32. If Government is minded to proceed with a portfolio holdings disclosure regime, we agree that the most sensible approach is for holdings to be disclosed for relevant investment options rather than on a whole-of-fund basis. We therefore endorse the direction in which the amendment legislation is heading.

33. It did occur to us that it was anomalous for the dashboard requirements to be limited to only the 10 largest investment options offered by a fund, but for the far-more granular portfolio holdings disclosure regime to be extended to every single investment option, regardless of how small. We suggest that consideration be given to harmonising these requirements so that funds do not have to provide portfolio holdings disclosure for options that are so small that they are exempt from the dashboard requirements.

34. We reiterate our comments above in relation to preparing dashboards for investment options which are substantially identical to other investment options in the same fund and why aggregation should be permitted in those cases. It is quite common for funds to offer the same choice of investment options to different sections of their membership. For all intents and purposes, they are the same investment option, but for technical reasons (e.g. they are offered to different sections of the membership

representing separate sub-plans and/or governed by a separate division of the trust deed) they may be separate investment options.

35. In our view, aggregation should be permitted in these cases. For example, say that a fund offers the same High Growth Option to members in five different sub-plans of the fund. Assume further that the funds under management in each version of the High Growth Option are $20M, $30M, $40M, $50M and $60M. In our view it makes sense for the fund to publish one portfolio holdings spreadsheet reflecting total funds under management of $200M, rather than 5 spreadsheets which would be identical in terms of the list of assets but in all other respects different only on a pro rata basis.

36. Clarification should be provided as to whether funds can (or should) aggregate investment options that, in practical terms, are the same investment option.

The defined benefit exemption

37. The exemption appears to exclude a defined benefit fund from any portfolio holdings disclosure, even in respect of its accumulation members. We query whether this is intended.

The 5% exemption

38. If the portfolio holdings disclosure regime will indeed apply to all investment options however small, the proposed exemption from disclosing up to 5% of the option's assets seems too low. For an option that is, say, only $50 million in size, 5% would be equivalent to only $2.5 million. If that option has any exposure to unlisted assets (which is where most of the valuation sensitivity lies) it is entirely conceivable that the exposure to a particular unlisted asset would exceed $2.5 million. In this scenario, the proposed relief would provide no relief at all.

39. We suggest that further consideration be given to using the power to declare a materiality threshold – for example, limiting disclosure to the top few hundred holdings or to holdings that represent more than, say, 0.5% of an option's assets.

The prescribed spreadsheet

40. Example 2.1 on page 17 of the Explanatory Memorandum is immensely helpful insofar as it shows how the different layers of assets would have to be published, because the associated drafting in draft regulation 7.9.07ZA(1)(g), (i), (j) and 7.9.07ZA(3) is extremely complex.

41. However, we do not understand the difference between column 3 ('number of units held in that product or property') and column 4 ('number of units held in any final product or property'). Clarification would be appreciated.

42. We also note that the requirements seem to be designed with unitised equity investments in mind. In practical terms, we assume it will be sufficient for funds to leave columns blank if they are not applicable to the relevant investment. For example, for investments in partnerships, unlisted property, bank accounts, loans and over-the-counter derivatives, it would not be possible to disclose a number of units or a unit price.

Attachment A

Profile of the Law Council of Australia

The Law Council of Australia represents the legal profession at the national level, speaks on behalf of its Constituent Bodies on national issues, and promotes the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2016 Executive as at 1 January 2016 are:

- Mr S. Stuart Clark AM, President
- Ms Fiona McLeod SC, President-Elect
- Mr Morry Bailes, Treasurer
- Mr Arthur Moses SC, Executive Member
- Mr Konrad de Kerloy, Executive Member
- Mr Michael Fitzgerald, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.