Address to Concurrent Forum #2

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Australian Securities and Investments Commission

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Introduction

Thank you Geraldine and good afternoon everyone.

It is great to be back in Brisbane, especially during a marathon state election campaign.

As a local government councillor, I am fascinated by the democratic process, and the ebb and flow of an election race.

But politics is not what I am here to discuss this afternoon. I will leave that to the commentators.

The conference program has me listed as speaking about ASIC's three strategic outcomes and how the super industry fits in with these.

It is a major topic and one that over the coming decade has massive implications for ASIC.

Let me explain.

This audience is keenly aware of the growth in Australia's pool of super funds. It is estimated that super funds under management will rise from $1.3 trillion to nearly $3 trillion over the next decade and then $5 trillion the next decade.

Compulsory contributions may increase to 12%, and with this increase will come greater community expectations for stronger protection and resilience in the financial system.

At the same time ASIC will need to regulate and facilitate an environment where an increasing proportion of consumers are in or transitioning to their retirement phase.

This growth and the structural changes in super, and the impact this has on the markets that ASIC regulates, are considerable. Super funds are invested in equities, bonds, managed investment schemes and other more complex products which fall within ASIC's remit.

Financial advisers, superannuation trustees, investment managers, custodians, research houses, credit rating agencies, auditors and accountants all play roles in supporting investors in superannuation funds, and are all regulated by ASIC.

So the growth in super raises substantial challenges for the Commission. They are challenges we look forward to addressing with the strong support of industry.

In the shorter term today I would like to make three points on:

- disclosure of underlying portfolio holdings;

- member statements in terms of performance and asset allocation disclosure; and
- the use of product ratings.

Disclosure of underlying portfolio holdings

ASIC’s first strategic outcome is confident and informed investors and financial consumers.

Disclosure and transparency is fundamental to achieving this.

The compulsory nature of superannuation and its tax advantages arguably raise the threshold of what the community expects in terms of disclosure and transparency.

Superannuation is a key pillar of Australia’s retirement income system and super funds have obligations to their investors to be accountable for their investments.

We consider that disclosure of the underlying portfolio holdings of super funds is a key part of the sector’s transparency.

Funds should already disclose significant information about the nature of their investments, such as providing a strategic or tactical asset allocation range in their PDS.

However, investors may be unable to access details of the specific investments in the range of investment options offered.

ASIC encourages issuers to make relevant and complete disclosure and we consider that enhanced disclosure regarding major portfolio holdings may play an important role in an investor’s decision to invest, remain invested or exit the product.

Earlier this year, we looked at publicly available information about the portfolio holdings of a range of Australian industry, retail and public sector superannuation funds, as well as managed funds. This was to determine current Australian practice in the absence of mandatory requirements.

We found that the overall disclosure was mixed, which can be expected where disclosure of this type is not mandatory.

Some super funds are already disclosing major portfolio holdings, most commonly on websites. Others provide this information to members who request it.

We are pleased to see industry bodies working together with a view to progressing this issue. In particular, ASFA and the FSC are working on industry guidance ahead of any Stronger Super reforms on this issue. We understand they are looking to release the industry standards by July this year.

We are happy for industry to lead the way in this. The move is to give those who want more information about their investment the ability to get that information.

Some might argue that there is little demand by members to obtain this information. While Australia's level of engagement with superannuation is quite low, ASIC is helping people become more engaged with their super through our independent website, MoneySmart. As their level of engagement rises, they will want to know more details about their investments and this will increase the demand for information about portfolio holdings.

As part of the Stronger Super reforms, the Government supports the MoneySmart website as the centralised superannuation website for consumers. MoneySmart is a useful resource to which you can refer your members for basic information about superannuation and other financial products.

Its content will be updated to reflect the Stronger Super changes and will explain these reforms in a consumer-focused way. The changes to MySuper are just as important for consumers as they are for the superannuation industry.

In order for investors to be confident and informed, they require access to important information about their investment, and this includes underlying portfolio holding information.

Member statements

The second point I'd like to raise is about improving member statements.

Too often, investors receive statements that outline the performance of the fund in comparison to other funds. This can be helpful for comparison purposes when those other funds have similar investment objectives.

However, it does not answer the fundamental question of whether the fund is meeting its stated objective. That is, is the fund doing what it said it would aim to do?

For example, take a member who is invested in the balanced option which has a stated objective to outperform CPI by 4% over the medium to long term. We would like to see the member statement show how that member's investment is tracking against the stated objective.

What is relevant to an investor is whether their investment is meeting its investment goal.

After all, the stated objective is a key factor in any decision to invest.

Members should be receiving information about how their investment option is performing against its stated objective. And we understand that this type of information is generally available (just not disclosed).

I'd like to raise another point on member statements.

Where you have a mixed investment option—for example, a growth or balanced option—there should be disclosure of the asset allocation as compared to an OECD benchmark.

This will assist investors to make a comparison with other funds.

For example, for a balanced option which has the stated objective to outperform CPI by 4% over the medium to long term, the asset allocation could be compared with the average of other OECD funds that have the same stated objective. So it could say that 40% is invested in equities, 20% in bonds, 30% property and 10% cash. This can then be compared to the OECD average which would have a greater weighting to bonds and less weight to equities.

This disclosure could be done on an 'if not, why not' basis. So if the disclosure is not made, there's an explanation why.

This will assist investors in understanding the strategy and risks of how the stated objective is being achieved by the fund. It will highlight any differences in approach between the fund and other OECD funds. After all, if the aim is to outperform CPI by 4%, investors should know whether their fund is taking an approach that is different to others.

Use of product ratings

The final point I wanted to make is on the use of product ratings.

As a result of the GFC and collapses in the mortgage fund, agribusiness, hedge fund and infrastructure sectors, research report providers have been criticised for publishing research that was unduly positive about firms that collapsed soon afterwards.

Last year, ASIC held discussions with a select group of research houses, as well as financial planning and advice industry associations and a number of their members. We also held talks with some industry associations representing other research report providers such as the AFMA and the SAA.

The three key issues that we identified were:

- the incidence, or the perception of, conflict of interests potentially arising through research houses' revenue model, ancillary businesses and analyst arrangements;
- the adequacy of skills and experience of research analysts in producing quality research; and
- the lack of transparency and comparability for research methodology.

Accordingly, in November 2011, ASIC released Consultation Paper 171 *Strengthening the regulation of research report providers (including research houses)* (CP 171), which proposed guidance and stronger standards for research report providers to improve the quality and transparency of the research they provide to wholesale and retail clients.

CP 171 relates to all providers of external research, whether labelled as fund ratings, securities research, investment research and so on. It does not, however, apply to internal research—for example, research prepared and used within a company only.

Specifically, we proposed:

- strict segregation between research and non-research business units; and
- a biennial compliance report would be required from all research report providers.

We also consulted on how a key conflict—issuers paying for research—should be managed. Is disclosure adequate, or should this conflict be avoided—that is, change the business model?

We received 29 submissions in total and are currently revising Regulatory Guide 79 *Managing conflicts of interest: A guide for research report* (RG 79) *providers*, which will set out the stronger guidance and standards. We are aiming to publish this in mid-2012.

This is a complex issue and while we are developing standards, care should be exercised when using product ratings.

Conclusion

As I mentioned earlier, superannuation impacts ASIC at nearly all levels. Its rapid growth presents a difficult challenge in terms of ASIC achieving its three strategic outcomes.

The three points I'd like you to take away from this session are:

- portfolio holdings disclosure;
- improving member statements by disclosing performance against the investment objective and ‘if not, why not’ disclosure of asset allocations compared with an OECD benchmark; and
- be aware of the issues involved in the business models of research houses in the use of product ratings.

Thank you. I’m happy to take questions.

