



Australian Private Equity &  
Venture Capital Association Limited

12 February 2014

Dear Sir/Madam

**AVCAL submission to Discussion Paper on superannuation regulation and governance**

The Australian Private Equity and Venture Capital Association Limited (AVCAL) welcomes the opportunity to respond to the Discussion Paper on "Better regulation and governance, enhanced transparency and improved competition in superannuation" released on 29 November 2013.

AVCAL represents the venture capital (VC) and private equity (PE) industry in Australia, with \$24 billion in funds under management. VC and PE are key sources of capital investment for Australian companies of all sizes, to enable their growth and realise their potential. Over the last ten years, the PE and VC industry has invested \$31 billion in private businesses, on behalf of investors such as superannuation funds, financial institutions and public sector funds.

AVCAL strongly supports transparency and disclosure by superannuation funds. Ensuring that fund members are provided with meaningful and timely information about the investment performance of their retirement savings is clearly an important element of helping to improve the level of engagement between fund members and their superannuation funds.

However, it is vital that any such disclosure does not result in an outcome that is detrimental to superannuation members' interests, which would be contrary to its policy intent.

Full look through Portfolio Holdings Disclosure would pose a considerable risk that certain investment opportunities will effectively become unavailable to Australian superannuation funds. This is because requiring the public disclosure of the value of unlisted assets, such as PE holdings, could have a negative impact on the performance of those investments where these valuations are commercially sensitive. Fund managers will be deterred from seeking capital from local superannuation funds if, by doing so, they become subject to a disclosure regime that is in excess of that required in other jurisdictions and which erodes the commercial value of investing in unlisted assets in Australia.

While there is no issue with providing this information to the relevant regulatory agencies for supervisory purposes, there should be a specific exemption for unlisted investments from the public disclosure of commercially sensitive information. The disclosure of such information – particularly information on ownership percentage, cost, valuation and distributions – would constitute a breach of the contractual confidentiality arrangements usually found in the legal documents that govern the relationship between the superannuation fund and its PE and VC fund managers.

Even if there is a materiality threshold and the likelihood of triggering that threshold is small, the absence of explicit provisions to protect confidential data means that RSEs will still need to renegotiate investment management agreements with each of their PE and VC fund managers to recognise that confidential information may be disclosed under the new reporting standards. In many cases this may not be possible and the RSEs may find themselves obliged to divest their existing holdings in high-quality investments, and unable to make new commitments to attractive new opportunities.

AVCAL is of the view that the Portfolio Holdings Disclosure regulations should seek to avoid the unintended consequence of Australian superannuation funds having to divest well-performing illiquid assets in order to comply with the regulations. This would also be a counterproductive outcome for superannuation investors who want to support the local economy through commitments to PE and VC funds, but become unable to access this asset class as their disclosure obligations will make them less preferred investors.

AVCAL also has specific concerns over any disclosure model that results in an uneven playing field between domestic and foreign investment managers whereby the former are obligated to comply and the latter are not.

For these reasons, AVCAL believes that full look through disclosure will not deliver on the Government's policy objectives, and will at the same time have significant compliance and performance cost implications.

AVCAL proposes that there should be a specific exemption from public disclosure of any commercially sensitive information in relation to superannuation funds' PE and VC investments. Such information should be determined to be confidential in order to mitigate the costs and risks to investors resulting from public disclosure, as outlined above.

Given that alternative models of Portfolio Holdings Disclosure are currently being considered, AVCAL is of the view that the start date of 1 July 2014 should be deferred to provide super funds and their managers with sufficient time to prepare and test the eventual disclosure model with members and advisers. This will allow them enough time to ensure that the information is meaningful to the target audience. The required disclosure processes also need to be developed and tested with superannuation providers and their investment managers to ensure they are workable, cost-effective and appropriately balance investor comprehension and access, efficacy at achieving policy outcome, cost, efficiency, protection of confidentiality obligations and competitive neutrality.

If you would like to discuss any aspect of this submission further, please do not hesitate to contact me or Dr Kar Mei Tang on (02) 8243 7000.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Yasser El-Ansary', with a long horizontal stroke extending to the right.

**Yasser El-Ansary**  
Chief Executive  
AVCAL

## AVCAL SUBMISSION

1. AVCAL is supportive of the work being undertaken by the Government to enhance transparency in superannuation funds. We have set out our responses below to the focus questions raised in the Discussion Paper on "Better regulation and governance, enhanced transparency and improved competition in superannuation".
2. With regard to the Choice Product Dashboard, AVCAL supports improved disclosure, accompanied by enhanced member education on using the dashboard. To meet the objective of providing greater comparability between products, Choice Product Dashboards must enable, but not unduly bias, decision-making by members and super fund trustees. For example, if the disclosure of investment fees or illiquidity metrics is mandated without adequate member awareness of the legitimate role of certain fees and illiquid assets in diversified portfolios, this may discourage trustees from investing in assets that may result in perceived "unfavourable" results relative to their peers, even if the expected long term net returns justify those decisions. The design of the Choice Product Dashboard should not inadvertently create a bias towards low fee, liquid products to the detriment of members' long-term interests, as unlisted assets are typically important considerations in diversified pension portfolios around the world.
3. With regard to Portfolio Holdings Disclosure, AVCAL believes that the information disclosed must be sufficiently useful and meaningful to fund members to justify the regulatory and other costs of such disclosure. In this regard, we believe that there are three overarching principles that need to be considered:
  - a. First, it is critical that disclosure is meaningful to consumers and advisers who will be reading and using the information disclosed to inform investment and other decisions. As such, consideration must be given to the appropriate amount, level and nature of the information disclosed and how it is described and laid out. The rules need to be tested with consumers and advisers to ensure that the information is meaningful and useful to them.
  - b. Second, it is also essential that the Portfolio Holdings Disclosure framework takes account of the numerous stakeholders who manage superannuation assets and hold them in custody on behalf of trustees. The framework needs to be workable, cost-effective and appropriately balance investor comprehension and access, efficacy at achieving policy outcome, cost, efficiency, protection of confidentiality obligations and competitive neutrality.
  - c. Third, it is vital that any such disclosure does not result in a net outcome that is detrimental to superannuation members' interests, which would be contrary to its policy intent.

## Focus Questions: Portfolio holdings disclosure

### Presentation of portfolio holdings

Q 20. Which model of portfolio holdings disclosure would best achieve an appropriate balance between improved transparency and compliance costs? 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)?
- 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.
- Should portfolio holdings disclosure be limited to the information required to be provided to APRA under *Reporting Standard SRS 532.0 Investment Exposure Concentrations*?

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

4. **Implications of a full look through approach.** AVCAL believes that current legislative requirements for full look through to the final asset, including investments held by collective investment vehicles would be detrimental to super fund members' interests. The reasons are given below:

- a. **Commercial sensitivity.** When a superannuation fund invests in a PE or VC fund, it receives, on a regular basis, detailed commercial and financial information about the individual companies the PE or VC fund invests in. The requirement for the periodic reporting of this information is set out in the legal documents that govern the relationship between the investor and fund manager (Limited Partnership Agreements or LPAs).

This information is used by superannuation fund investors to fulfil their fiduciary obligations in relation to monitoring and assessing their investments. However, public disclosure of this information may have a significant negative impact on the value of that investment, and ultimately on the member beneficiary's financial interests.

For example, say an RSE trustee holds an interest in a PE fund that is invested in an unlisted Australian business. At some point, the PE fund manager will seek to sell that interest at the best price it can obtain for its investors. Public disclosure of the book value attributed to that unlisted interest would adversely affect the fund's ability to obtain any sale price above the book value. It puts these companies at a significant commercial disadvantage in negotiations with potential buyers, and creates an uneven playing field when other non-PE-backed unlisted companies would not have to publicly report the type of sensitive information that is shared with investors in PE funds.

Similar issues arise when, for example, a PE or VC fund is in a position to acquire an additional interest in an existing asset through the exercise of a pre-emptive right at a discount to the fund's book value.

Public disclosure of the investment vehicle's valuation can also pose the risk of individual asset valuations being identified, as PE and VC funds typically have only a small number of investments per fund (the investment vehicle).

- b. **Absence of normal exemptions for commercially sensitive information.** In the US, most states' Freedom of Information Act (FOIA) laws protect confidential commercial information. For the avoidance of doubt, many impose specific protections for the information PE funds share on a confidential basis with their state investors. For example, California law specifies a list of exemptions for alternative investments from commercially sensitive disclosures, including exemptions from disclosing records containing information regarding a fund's individual portfolio investments.<sup>1</sup> Minnesota law specifically considers data on the state's and public pensions' limited partnership investments to be non-public if "the release of which could cause competitive harm" to the state board.<sup>2</sup> Similar protections or carve-outs for commercially sensitive PE investment information exist in other states including Illinois, South Carolina and Texas.
- c. **Loss of capacity for Australian super funds to access top-tier PE and VC funds.** PE and VC fund managers, and fund-of-funds, almost always incorporate confidentiality arrangements in their LPAs with their investors. While superannuation funds may sometimes seek exceptions to these confidentiality arrangements for regulatory requests, this is on the basis the regulator is seeking information for supervisory purposes only, and not for public disclosure.

However, the current legal obligation to disclose portfolio holdings on a full look through basis is absolute with no carve-outs for commercially sensitive information or contractual confidentiality obligations. Publishing confidential valuations would violate most LPAs and undo years of effort in building relationships with top-tier PE and VC funds. The only solution, if a PE or VC fund manager does not consent to the disclosure, is for the superannuation manager to either invest on a "blind" basis (i.e. specify that it does not wish to receive any data about the value of its investment in the fund, or the details of the underlying portfolio companies), or to not invest in the fund altogether.

A number of superannuation funds have approached AVCAL citing this as a significant impediment in carrying out their investment mandates effectively. We have already observed at least one superannuation fund in recent months which was unable to invest in a sought-after, top-tier foreign PE fund solely on the basis of the impending look through disclosure obligations, thus missing out on a potentially attractive investment.

The experience of US investors suggests that this impact is likely to be far-reaching. For example, following a state court ruling in 2003 requiring compliance with a FOIA request for performance information, Kleiner Perkins stopped providing the University of California with fund-specific information for its existing investments, and stopped inviting the University to participate in new funds. Sequoia Capital requested the University to divest itself of any Sequoia holding in which the University was an investor. The

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<sup>1</sup> California Public Records Act, § 6254.26.

<sup>2</sup> Minnesota Statutes 2013, § 11A.24.

University had until then a 22-year relationship with Sequoia. News reports at the time also indicated that a number of top-tier US funds such as Benchmark Capital, Charles River Venture Partners, Sequoia Capital, and Woodside Fund chose not to pursue public money for their latest funds at that point.<sup>3</sup>

A similar outcome here would harm superannuation members – who lose potentially attractive long-term investment opportunities – as well as PE and VC funds and their investees, which lose access to an important source of capital.

- d. **Cost of managing breaches of existing contractual agreements.** As part of the process of complying with full look through Portfolio Holdings Disclosure, super funds would need to negotiate the appropriate provisions in side letters to their LPAs with all of their PE and VC funds. If the super funds have investments through fund-of-funds, these fund-of-funds would need to do the same with the funds they invest in.
- e. **Costs of implementing the full look through requirement on an ongoing basis.** The super fund would need to invest in setting up the appropriate templates and processes to update the required data on a semi-annual basis as required by the new disclosure framework. In most cases this may entail costly modifications to their existing systems which currently collect this data for monitoring purposes. This would require additional internal resources (e.g. through salaries and other associated costs) as well as additional custodian costs.
- f. **Absence of a reasonable materiality threshold imposes costs which far outweigh the marginal benefit to members.** The requirement for full look through will result in large amounts of non-material information being released to the public, at considerable commercial cost to the investment managers, which will ultimately flow on to super fund members. Although PE programmes vary substantially across super funds, as an illustrative example we can examine the extent of disclosure involved for a single medium-sized superannuation fund which has 2% of its total assets invested in 10 PE and VC funds, of which 2 are direct investments and 8 are through fund-of-funds. Assuming the PE/VC funds are invested in an average of, say, 4 companies per fund at any point in time and the fund-of-funds have an average size of 15 funds, this means that the super fund would need to disclose nearly *500 private company valuations* for an asset class that only makes up 2% of its total assets.

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<sup>3</sup> *Regents of the University of California v. The Superior Court of Alameda County*, 2013; Illinois Venture Capital Association, [Freedom of Information Act Clarification for Private Equity Portfolio Company Information](#), 2005.

5. **Alternative Model 1: Separate disclosure obligations for super funds and CIVs.** This model implies partial look through by the super funds, accompanied by a separate obligation for full look through by all Australian-domiciled collective investment vehicles. In our view this poses two main problems:
- a. This model does not resolve the issues set out in point 4 regarding commercial sensitivity, loss of access to top-tier funds, and the implementation costs outweighing the marginal benefits of full look through to all assets. The main difference from the original model would merely be to shift some implementation costs from the superannuation funds to their external fund managers.
  - b. There is insufficient information to assess how this model can be operationalised to enforce compliance by all external fund managers without imposing costs which may ultimately be passed on to fund beneficiaries. This model would also result in the inconsistent treatment of all Australian fund managers compared to foreign fund managers, as noted in the discussion paper.
6. **Alternative Model 2: Limiting disclosure to APRA Reporting Standard SRS 532.0.** AVCAL believes that leveraging on existing APRA reporting standards will keep data collection consistent and cost-effective whilst also meeting the objectives of portfolio holdings disclosure to "enable members and analysts to better assess the level of diversification and risk in particular products" (Discussion Paper p.21).

With regard to APRA Reporting Standard SRS 532.0, the materiality threshold of 1% of total assets is helpful in limiting the costs of publishing large volumes of information on very small portfolio exposures. However, there are two key concerns with making SRS 532.0 information public:

- a. Where there are occurrences of unlisted investments (whether intermediated through funds or through co-investments with PE and VC funds) triggering the materiality threshold, the information disclosed – particularly information on ownership percentage, cost, valuation and distributions – are regarded as commercial-in-confidence and their disclosure would give rise to the problems described in point 4.
- b. While there is no issue with providing this information to APRA for prudential purposes, AVCAL is of the view that there would still need to be a specific exemption for unlisted investments from public disclosure. Even if the likelihood of triggering the materiality threshold is small, the absence of explicit provisions to protect confidential data means that RSEs will need to renegotiate investment management agreements with their PE and VC fund managers to recognise that confidential information may be disclosed under the new reporting standards. In addition, top-tier funds may choose not to admit Australian superannuation investors that are subject to a regulatory regime that may entail the disclosure of commercially sensitive information.

**Materiality threshold**

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

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

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

7. See answers in points 4(f) and 6 above.

**Implementation issues**

Q 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?

8. AVCAL is of the view that the Portfolio Holdings Disclosure rules need sufficient time to be tested with consumers and advisers to ensure that the information is meaningful and useful to them. They also need to be tested with superannuation providers and their investment managers to ensure they are workable, cost-effective and appropriately balance investor comprehension and access, efficacy at achieving policy outcome, cost, efficiency, protection of confidentiality obligations and competitive neutrality.

If the full look through model is adopted, some super funds are likely to not be ready by 1 July 2014. They would need to not only prepare the data, but also finalise the relevant renegotiations of LPA terms, decide and act on what to do with PE or VC commitments and investments that need to be divested, and set up the appropriate templates and processes to update the required data on a semi-annual basis.

Given this, and the fact that alternative models of compliance with Portfolio Holdings Disclosure are currently being considered, AVCAL submits that the start date of 1 July 2014 should be deferred to provide super funds and their managers with sufficient time to prepare and test the eventual disclosure model with members and advisers. This will also provide them with sufficient time to set up and complete the necessary legal and compliance settings and procedures required for the new disclosure framework.