Cuffelinks
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Let's kick this political football out of the ground

Chris Cuffe

The legendary football manager Bill Shankly built Liverpool into a powerhouse of the English game, and he once told an interviewer:

"Some people believe football is a matter of life and death, but I am very disappointed with that attitude. I can assure you it is much, much more important than that."

It's reached such a stage with superannuation. How did it come to this? When I first became involved in wealth management almost three decades ago, it was unthinkable that superannuation would be one of the hottest social and political issues of the day. Now, I don't know whether it's wonderful or woeful that superannuation has become a major election issue, with undertones of social divide and even class warfare. Compulsory super for all workers did not start until 1992, when it was more likely that Azaria Chamberlain and a dingo would dominate the news, not some strange retirement savings plan.

I say 'wonderful' because millions of Australians are now thinking about and planning how to finance their retirement, and the superannuation pool has grown to $1.5 trillion, equal to the country's GDP. In coming decades, the system will give strength to Australia's public finances as a high proportion of the population will fund their own retirement.

But I also say 'woeful' because what should be an achievement to celebrate has become highly divisive. It has triggered a debate about whether someone with $800,000 in super is 'rich', with the latest furore over former Gillard Government Minister Joel Fitzgibbon saying a family in Sydney's west earning a quarter of a million dollars a year could be struggling. The Treasury estimate that super concessions are costing $32 billion a year and rising rapidly has become the way to finance everything from the overall budget deficit, hospitals, schools and disability services.

It's not just a political divide, as on the Labor side of politics, a steady stream of party stalwarts, such as Bill Kelty, Martin Ferguson and Simon Crean, and recently, Paul Keating within the pages of *Cuffelinks* itself, have been telling the current Government not to meddle with one of the party's proudest achievements. They point out that many of traditional blue collar Labor supporters have accumulated $800,000 in super and invested at 5%, that's only $40,000 a year.

In my view there's only one way we can go with this, as super is too important and too big (heading to $6 trillion and 200% of GDP by 2030) to be punted around by shock jocks and weekly opinion polls. We need a completely independent and bipartisan group to provide ongoing opinion and direction about our superannuation system. A decent model to start with is the Board of Taxation. Here's an extract from their website:

"The Board of Taxation

The Board of Taxation is a non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation.

The Board is tasked with advising the Treasurer on improving the general integrity and functioning of the taxation system and commissioning research and other studies on tax matters approved or referred to it by the Treasurer."

The operations of the Board are governed by its Charter, and are supported by a Secretariat provided by the Treasury."

I envisage an independent superannuation body having up to 10 people in the group, comprising experts on matters affecting superannuation, such as taxation, demographics, investments, structuring, insurance, actuarial skills, etc. The individuals would be appointed by the Treasurer and be required to relinquish all commercial activities in the super space. In turn, the government would pay each person for having no conflicts and for joining the group. A properly-resourced secretariat with an appropriate budget would be available to the group as well as access to modelling and data from the ATO and Treasury.

The problem we have at the moment is that opinions come from so many people with vested interests or conflicts, be they industry associations, retail and institutional superannuation providers, industry funds, asset consultants, research firms, etc. For example, when an organisation like the SMSF Owners' Alliance or the Financial Services Council puts out a research paper showing that the cost of super tax incentives is recovered in lower pension outlays, the work is dismissed by many due to a perception of obvious bias. An independent superannuation group would minimise the accusations of vested interests. The debate lacks pure, considered, unbiased, informed opinion.

The proposed group would:

- produce white papers on the long term direction and needs of super
- be a source of advice for Treasury and the government when developing policy, and in particular the long term implications of such policy
- have bipartisan support and respect, based on a solid and well-considered path for its direction, and to minimise the tampering and tinkering that comes with all new government appointments.

A useful example of an issue it could address is this $32 billion number currently being bounced around as the 'cost' to the government of the current superannuation concessions. A closer look shows it assumes that people would pay tax at their marginal rates rather than the rates within super. But we know that people arrange their financial affairs according to prevailing opportunities, and it's more likely that behaviour would change rather than people paying the top tax rate.

An independent group would also minimise the 'class divide' issue that is inevitable when policy comes from one of the two major political parties. For example, is it correct to assume (as many people do) that a wealthy retiree over the age of 60 should not have the right to all withdrawals and all income free of tax? If someone has worked hard for 40 years, already paid tax at high marginal rates, deferred consumption by living in a modest house and buying a used car, legitimately used the system which encouraged self-sufficiency by making non-concessional contributions, and planned their life within the rules designed by the government, then many others would argue they have every right to object if they are hit by a major change.

We need checks and balances in the system that an independent superannuation voice would help provide to ensure super taxes are not altered merely in response to balancing the budget in one particular financial year. Any proposed change to the system would not only focus on the super taxation rules, but relationships with age pension eligibility, mortality, longevity, volatility, death duties and estate planning.

We need experts from within the industry to be part of this independent superannuation group, and these are not just the investment managers. Superannuation is a massive industry and it reaches into financial planners, custodians, real estate agents, property developers, dealer groups, trustees, platform managers, lawyers, consultants, accountants, tax advisers, brokers. The list goes on. It's often said that a poacher turned gamekeeper provides valuable insights!

Superannuation is part of everyone's future. The demographic trends of longevity and improving mortality will not go away. A Board of Superannuation would help any government of the day fight against the vested interests and rent seekers who would inevitably oppose any reform, and take some of the hyperbole from the debate.

At the end of his career, when Bill Shankly was asked to sum up his essential criteria for success in football management, he said, "I could speak common sense about the game and I could spot a player." That's the sort of level-headed approach we need for superannuation.

Debating the value of super

Pauline Vamos

There is much debate about the superannuation system. Constructive and informed debate is welcome on any social and economic issue and in particular super, but we really need to raise the quality of the discussion. So-called facts and figures are quoted and relied upon by commentators, public figures, stakeholders and interested parties. I often feel there is not enough done to balance the debate, which is the aim of this article.

Some examples of misleading statements heard or read are in italics below.

- *The tax assistance for superannuation costs about $32 billion in 2012-13.* It is actually about half that and the pool contributes many millions in both direct and indirect tax.

- *Most retirees are still on a full or part pension so the system is not doing its job.* Without superannuation, the age pension bill might be some $7 billion per annum higher than it currently is. By 2037 it could be $55 billion per annum higher without superannuation on the basis that the growing pool of superannuation savings will reduce expenditures on age pensions by about 1% of GDP. Further, with compulsory superannuation, a single person who is on average earnings of $70,000 a year will retire with around $425,000 in today's dollars and have an income in retirement which would be nearly 90% higher than provided by the age pension alone.

- *The very wealthy get the best deal from super.* This was probably true in the past but the amount of government assistance provided to individuals at high income levels has been substantially decreased by lower caps for concessional contributions (reduced to $25,000). In addition, the majority of those on above average incomes will receive either no or only a part age pension when they retire. When all these factors are taken into account, the amount of assistance for retirement is broadly comparable across all income tax payers. The Treasury estimates that the present value of government assistance for both the age pension and superannuation is just under $300,000. A low income person will receive this mostly in the form of age pension, while a person at the top of the income distribution will receive it as tax concessions for super. The elephant in the room in this debate is the ability for people to put in $150,000 a year in after-tax dollars and then receive tax concessions in both earnings and withdrawals after retirement age. At this time, few people can and do take advantage of the opportunity – this may or not change in the future.

- *The super pool provides no real economic value to the Australian economy.* Superannuation is projected to lift household savings by around 2.5% of GDP, thereby enhancing the ability of Australian businesses and governments to finance investment and infrastructure without undue reliance on foreign savings and investment. As well, superannuation will mean that an increasing proportion of retirees in the future will be important contributors to domestic demand. Current benefits boost domestic demand by over $50 billion a year and this figure could increase four fold by 2040.

- *The super pool is not used for infrastructure investment.* About one third of large super funds invest in infrastructure with asset allocation ranging from 2 to 10%. Both figures are expected to increase as funds get larger, mergers occur and investments focus more on delivering post retirement incomes. There are however a number of stumbling blocks including liquidity requirements, portability and the fact that only about $400 billion of super is in default portfolios. The bulk of the $1.5 trillion is in SMSFs and choice portfolios where the investor decides the asset allocation. This is clearly the major difference between the Australian super system and overseas pension systems which are predominantly defined benefit.

There is no doubt that some of the rules on the transfer of business assets and the previous ability to put large amounts of money into super favour certain groups of people, particularly if all income and benefits (no matter at what level) remain tax-free in retirement. Any retirement system must have a ceiling as well as a floor. We need to review the anomalies that promote estate planning rather than retirement incomes, and we also need to fix the gaps (particularly for the self-employed), and move the system to an income-orientation. But let's stop the hysterical and ill-informed debate.

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APRA helps SMSFs but large super funds left hanging

Graham Hand

There is a major disconnect in the Australian financial system which the regulators are doing little to correct. Much of the nation's saving is in the superannuation system (currently $1.5 trillion and heading for $6 trillion by 2030) while much of the nation's funding need is in the banking system (total loans of the four major banks of $1.8 trillion are greater than their deposits). The obvious solution is to make it easier for publicly-offered super funds to invest in bank deposits, but some recent regulations operate in the *opposite* direction. Furthermore, they create more incentives for investors to set up SMSFs at the expense of publicly-offered super funds.

Consider the aggregated balance sheets of our four major banks:

	Sept 2011	Dec 2011	Mar 2012	June 2012	Sep 2012
Total assets ($m)	2,705,084	2,670,694	2,701,831	2,787,764	2,793,845
Average net loans and advances ($m)	1,722,444	1,754,831	1,780,997	1,810,176	1,837,800
Average deposits ($m)	1,489,466	1,534,986	1,555,124	1,589,571	1,622,337
Growth in total assets	**5.9%**	**-1.3%**	**1.2%**	**3.2%**	**0.2%**
Net loans to deposits	**115.6%**	**114.3%**	**114.5%**	**113.9%**	**113.3%**
Deposits to assets	**56.6%**	**57.1%**	**57.9%**	**57.9%**	**58.1%**
Equity to deposits	**10.5%**	**10.5%**	**10.5%**	**10.4%**	**10.4%**

Source: Quarterly Bank Performance, APRA, issued 21 February 2013

The ratio of deposits to total assets of the major banks is only 58%, and the amount of their loans is 113% of their deposits. The funding shortfall comes primarily from two sources: wholesale short term money markets ($205 billion), and longer term bond markets, mainly offshore ($465 billion). In times of market distress such as during the GFC, the reliability of offshore funding falls away, and short term wholesale sources quickly seek the greater security of government paper. So it is in the interests of bank funding stability that they finance themselves more from stable, long-term retail sources, such as deposits from the superannuation system (including retail platforms and wraps).

Unfortunately, the proposed Australian Prudential Regulation Authority (APRA) Prudential Standards on Bank Liquidity (APS210) discourage this meeting of large super funds and bank deposits.

To see how the liquidity regulations work, let's take a quick quiz, looking at Mrs Walsh making the same investment three different ways. There's one rule: 'retail' is good and 'wholesale' is bad.

Question 1. When Mrs Walsh, a long time Westpac client, walks into Wagga Wagga branch and deposits $10,000 in an at call Westpac deposit, can the bank classify it as a long term retail deposit?

Answer 1. Yes, the liquidity rules treat this as a 'sticky' retail deposit, which is wonderful because the bank does not need to allow for Mrs Walsh's ability to take the money out the next day. The bank does not need to hold any expensive liquidity to support the deposit, so Westpac loves this type of money and will pay Mrs Walsh an attractive interest rate. Smiles all round.

Question 2. When Mrs Walsh, a long time Westpac and BT Investment Management client, walks into Wagga Wagga branch and deposits $10,000 in an at call Westpac deposit offered on BT's super platform, can the bank consider it a retail deposit?

Answer 2. No, the liquidity rules classify this as 'wholesale' because the super fund has a trustee which is not a 'natural person' making the deposit. Westpac must hold low-yielding liquid assets to support this deposit, and it has suddenly lost its 'sticky' characteristics. Westpac doesn't like it and so offers a lower rate to the super fund. Frowns all round.

Following so far?

Question 3. When Mrs Walsh, a long time Westpac client and recent proud owner of an SMSF, walks into Wagga Wagga branch, and in the name of the corporate trustee of her SMSF, deposits $10,000 in an at call Westpac deposit, can the bank consider it a retail deposit?

Answer 3. Yes, because although the investment is held in the name of a corporate trustee, not a 'natural person', APRA has granted special treatment for SMSFs. Again, Westpac is not required to hold expensive liquidity to support this deposit. Good rates and more smiles.

Still following? The obvious bunnies missing out are the large public super funds and their clients, and it's perplexing to Mrs Walsh who thought she was making the same deposit into her bank.

In *Cuffelinks Edition 2,* we demonstrated how the government deposit guarantee does not apply for investors using publicly-offered super funds to deposit funds in banks. Now, the effect of APS210 is that deposits made via the same public super funds will be considered volatile, wholesale money on which banks will be less willing to pay competitive interest rates. SMSFs have a special exemption which categorises them as stable, retail depositors.

The lack of significant superannuation industry lobbying against the terms of the government guarantee and the liquidity rules is mysterious because they make little practical sense, either from the bank, superannuation or good liquidity management perspective. The days are long gone when the super industry could ignore what is happening with bank regulations, as retail investors have flocked into billions of dollars of bank deposits on super platforms in the last few years.

In fact, most of the major retail fund managers did not offer bank term deposits or bank cash accounts on their platforms until 2008 or later, and many industry funds still do not give their customers a range of term deposits to select. Their customers who want cash or term deposit exposure must choose managed funds such as cash trusts that invest in such instruments.

Even before APS210 hits, there are two problems for publicly-offered super fund investors that direct bank depositors and SMSFs can avoid: the first is that administrators of large super funds take a platform management fee; and the second is that large super fund investors are unable to take advantage of special 'blackboard' deals offered by banks. For example, although the cash rate is only 3%, it is not difficult for a bank customer or SMSF to earn 4.5% on a bank deposit. Such rates are not available in the wholesale money market because the banks only pay up for deposits classified as genuine retail. Large publicly-offered super cash funds are already uncompetitive compared with term deposits, and APS210 will only make it worse.

Exactly how do the new liquidity regulations create this outcome? (note, this is not about bank capital, that is a different set of regulations).

Under the direction of the Bank for International Settlements and Basel III, APRA is introducing a new standard called the Liquidity Coverage Ratio (LCR). It requires banks (and other Authorised Deposit-taking Institutions) to hold High Quality Liquid Assets (HQLAs; basically government securities) against liabilities maturing within 30 days, or any term deposit where the investor has the right to redeem early. Retail deposits are considered 'sticky' and the most stable of deposits, and do not need to be included in the 30 day maturity bucket, even if they are at call. Retail deposits must come from a 'natural person', not a trust.

Banks will be willing to pay more for retail deposits because they do not need to hold HQLAs against them, which is estimated to cost up to 80bp pa due to the lower yield on government securities. This is the potential disadvantage facing institutional super funds. Recent announcements from Basel indicate some relaxation regarding which assets qualify as HQLAs, opening the door to better returns, but APRA is reluctant to ease the rules in Australia.

What about those institutional super funds which offer bank deposits on their super platforms or wraps, where a retail investor directly selects a deposit issued by a specific bank? Surely this is a retail deposit, as it is a retail investor making the decision, not a fund manager. It would be almost impossible for the trustee to act against the instructions of the depositor, at least within the defined 30 day period.

At first glance, it appears these deposits will receive favourable APRA treatment as retail, as the Discussion Paper on Basel III, page 18, states:

"APRA recognises that there are some deposits that are acquired by an ADI through an intermediary but can be retail in nature where the natural person retains control. Subject to meeting certain conditions, as outlined in draft APS210, ADIs can treat these deposits as retail for determining cash outflows under the LCR scenario."

So far so good. But what are these "*certain conditions"?* A massive sting in the tail, that's what. The criteria to gain the favourable retail treatment include: *the natural person must retain all legal rights, which cannot be transferred to an intermediary. The intermediary can have no duty to make investment decisions on behalf of the natural person.*

In Australia, all superannuation money must be invested through a trust that complies with the Superannuation Industry (Supervision) Act 1993 (SIS Act). All super funds are trusts with a trustee. Therefore, all natural persons putting money in a super trust must be transferring rights to an intermediary (but with a special carve out for SMSFs), and all money invested by institutional super funds will be considered as coming from a financial institution.

Both the Basel rules and APRA judge money from financial institutions to be 'hot' and an unstable source of funding, and the regulations will discourage banks from raising this type of money, and provide another boost to SMSFs.

It's not a good prospect for publicly-offered super funds as investors seek the security of bank deposits, and it will do nothing to reduce the reliance of our banks on wholesale and offshore funding. We should be designing the system to put super money and bank deposits together, not force them apart.

A longer version of this article was first published in Banking Day (www.bankingday.com).

Improving access to liquid alternatives

Dominic McCormick

One of the big criticisms of many alternative investments, particularly for retail investors, is their poor or uncertain liquidity. This was highlighted in the GFC for small and large investors alike, as a range of alternatives funds failed, suspended redemptions, or were difficult to exit at other than significant discounts to full value. As a result, some retail investors remain cautious about alternative investments, demanding greater and more reliable liquidity. Fortunately, the scope for retail investors to access and build portfolios of reliably liquid alternative strategies and assets continues to improve.

First, let's clarify what we mean by 'alternative investments'. A simple definition is any investment that is not one of the traditional asset types of cash, bonds and equities. It is broader than simply 'hedge funds' and includes precious metals, commodities, private equity and 'quasi alternatives' like listed infrastructure and property.

Divergent liquidity preferences

It seems retail investors have developed two broadly divergent preferences regarding liquidity on investment products in the wake of the GFC. On the one hand they desire that the bulk of their investments provide very high liquidity, ideally daily or perhaps weekly. On the other hand, they will accept highly illiquid investments in asset classes they know well, typically with a defined future date for repayment or a liquidity event, such as a property syndicate. Ownership of direct residential and commercial property is another low liquidity asset. Investments that don't easily fit into these two broad categories from a liquidity perspective are generally being shunned.

The good news is that the ability of retail investors to access liquid alternative investments has improved in recent years and is allowing portfolios to contain a meaningful allocation to a range of alternative investments while remaining highly liquid. This is occurring at a time when alternative allocations up to 30% are being recommended by some asset consultants and research houses. Of course these liquidity-focused investors are not able to access the extensive universe of alternative asset and strategy opportunities that long term institutional pools of capital such as large super or endowment funds can, but nevertheless the choice is clearly expanding.

Availability of alternatives

Liquid strategies like managed futures have become well accepted by retail investors in recent years as major groups like Winton, Aspect and AHL have entered the market. Long/short equity is increasingly a strategy offered by mainstream and alternative managers with more frequent liquidity than the monthly or quarterly liquidity offered by standard hedge funds. There are also a small number of highly liquid global macro, Tactical Asset Allocation (TAA) funds and commodity-related funds. Other 'quasi alternative' categories like listed infrastructure funds have also proliferated in recent years.

Part of this trend to greater liquidity is being driven by the response of hedge funds and fund of hedge funds to the GFC. Hedge fund of funds groups in particular have been forced to totally re-work their offer, especially if they are intending to appeal to retail investors. Many have built managed account structures to access individual hedge funds that allow greater liquidity, transparency and lower cost. The growth of hedge fund beta products (that is, they earn a hedge fund return rather than the return of a specific manager) that offer lower cost and more liquid access to hedge fund diversification benefits has also expanded the retail universe.

Another driver to greater liquidity has been the desire of fund managers to offer their products in the US mutual fund market and European listed markets. These structures require much greater liquidity as well as having restrictions on leverage and compensation arrangements. Managed futures, long short, market neutral equity, merger and event arbitrage as well as more diversified fund offerings such as hedge fund beta and fund of funds are being designed for these markets, and the structures can then be replicated in Australia.

Exchange traded funds (ETFs) are also growing as a way to offer some alternatives despite the restrictions that this structure offers. For example, precious metal and commodity ETFs have grown rapidly in global markets in recent years, and are readily traded on the ASX.

Another small but often neglected area of liquid alternatives is listed investment companies (LICs). The advantage of this structure is that it can provide daily liquidity to those alternatives strategies that are inherently illiquid via trading on the exchange. Most prominent of these is private equity and debt although some less liquid hedge fund strategies and specialist areas like agriculture and timber have also been offered in this structure.

Of course this structure comes with some limitations, such as less manager choice, occasionally bad governance, and the tendency to trade up and down with the market irrespective of the value of the underlying strategy, which can dilute diversification benefits. Related to this is the tendency of these vehicles to trade at a discount or premium to Net Tangible Assets (NTA), although approached with discipline this can provide opportunities. If investors can be selective regarding manager quality and only buy LICs when they are trading at discounts to realistic NTA and where there are catalysts for that discount to narrow, these vehicles can provide very attractive returns. Such listed fund investments can be valuable satellite holdings or a complement to a broader liquid alternatives portfolio.

Consider as part of a portfolio mix

The liquid alternatives universe is clearly growing and enabling the construction of increasingly robust alternative portfolios for retail investors, something that would have been difficult to achieve just a few years ago. Of course, having a greater array of liquid alternatives to choose from does not necessarily make selecting them or building a portfolio an easy task given the complexity of many alternative assets and strategies. Further, there are many high quality alternatives managers and strategies that are difficult for retail investors to access for reasons other than liquidity, such as those without an Australian presence or operating only through offshore funds. This highlights the role that professionally managed pooled alternative vehicles, even if focused on mostly liquid funds, can provide.

Investors should welcome the greater availability of liquid alternatives, particularly in a world where expected returns over coming years on a range of mainstream assets classes are subdued and the risk-reducing and diversification benefits of a well-selected range of alternative investments are increasingly valued.

Dominic McCormick is Chief Investment Officer and Executive Director at Select Asset Management.

How ASIC defines 'hedge funds' and what it means to you

David Bell

In September last year, the Australian Securities and Investments Commission (ASIC) released a new regulatory guide, *RG 240 – Hedge Funds: Improving Disclosure* which included a definition of a 'hedge fund'. ASIC then established benchmarks and disclosure principles that should be included in Product Disclosure Statements (PDSs) for hedge funds. There are a number of interesting ramifications for the investing community.

Hedge funds and non-vanilla investments in general are a difficult area for regulators. By nature, this is a heterogeneous group of funds with vastly different characteristics. If regulators become too prescriptive the rules may not apply well to particular strategies or structures. However if they fail to establish appropriate standards then uninformed investors are at risk of unexpected poor outcomes. It is a tricky tightrope on which to walk.

Hedge fund definitions

RG 240 was initially released for consultation and the final version appears to have taken into consideration the feedback received. ASIC defines a hedge fund in two ways:

1. The fund itself is promoted by the responsible entity as a 'hedge fund', or

2. The fund exhibits two or more of the following five ASIC-defined characteristics:

   i. Complex investment strategy or structure
      - aims to generate returns with a low correlation to equity and bond indices
      - invests through three or more interposed entities (or two or more interposed entities if at least one of the entities is offshore) where the responsible entity of the scheme or an associate has the capacity to control the disposal of the products or two or more of the interposed entities. As an example think of a domestic fund that invests into an offshore structure over which the responsible entity has some sort of control

   ii. Use of leverage
      The fund uses debt to increase exposure to financial investments

   iii. Use of derivatives
      The fund uses derivatives, other than for the dominant purpose of:
      - managing foreign exchange or interest rate risk, or
      - more efficiently gaining an economic exposure to an investment, through the use of exchange-traded derivatives referenced to that specific asset, but only on a temporary basis (i.e. less than 28 days). An example of this would be using futures to gain exposure to equity markets following a large inflow, and subsequently replacing these exposures with actual stock positions

   iv. Use of short selling
      The fund engages in short selling

   v. Charge a performance fee
      The responsible entity (or investment manager) has a right to be paid a fee based on the unrealised performance of the fund's assets.

The definition is interesting. There are likely to be some cases where investment managers who consider themselves more traditional investment managers may now find themselves a hedge fund under ASIC's definition. An interesting case study is a number of funds managed by the very popular and successful Platinum Asset Management. The FAQ part of their website states,

"Is Platinum a Hedge Manager? No. We only partially hedge our share holdings with short sales and will generally have net long positions of 50% or more."

However their PDS discloses that they do take some short positions and that there is the option to charge a performance fee. Under ASIC's definition, they tick at least two out of the five criteria boxes and would be viewed as a hedge fund. Another example is the now-common equity income funds which may use derivatives and potentially meet ASIC's definition of a complex investment strategy. PDSs need to be updated to reflect these changes by 22 June this year.

Increased disclosure

ASIC is not necessarily attempting to portray hedge funds as poor or even exceedingly risky investments. Rather, it suggests that hedge funds are more complex in terms of understanding the risks and features and the role they play in a diversified portfolio. ASIC believes investors need greater disclosure for such products, including:

- investment strategy: detail of the strategy and exposure limits
- investment manager: increased disclosure around key staff, qualifications, background, employment contracts
- fund structure: detailed disclosure around the structure of the fund and service providers, fees through the structure
- valuation of assets: include location and custodial arrangements, and a list of all instruments and markets traded
- liquidity: description of liquidity policy and any illiquid positions
- leverage: disclosure of leverage and possible ranges
- derivatives: a fair amount of disclosure required
- short selling: policy and limits
- withdrawals: disclosure around withdrawals and associated risks.

ASIC calls these benchmarks and disclosure principles and advises that every PDS for a hedge fund should meet these disclosure requirements. However a responsible entity can adopt an 'if-not-why-not' approach where they do not disclose on a particular issue and clearly explain why they didn't disclose and the risks this may create for investors. Of course ASIC may choose to not approve PDSs which do not provide sufficient disclosure.

How do these ramifications affect different market participants?

Direct investors have the opportunity to be better informed. Following hedge fund losses such as Astarra Strategic Fund and Basis Yield Alpha Fund, it is understandable why ASIC wants to see better investor information. Question marks remain over the ability of non-financially educated investors to understand the risks even with this additional information, but financial education remains an ongoing industry challenge.

Financial planners may discover that they have exposed their clients to funds which may be subsequently re-defined as hedge funds. Do they have to change their statement of advice? Will PI (professional indemnity) insurance bills be higher for financial planning groups who include hedge funds on their approved products list? If they change client portfolios as a result there may be capital gains tax realisations.

Institutional investors such as super funds should be the least affected as they either have an internal investment team or an external asset consultant which should be professionally assessing each individual investment on its merits.

Finally, it is the actual underlying investment managers (or hedge fund managers) who may be the most affected. They may feel that some of the disclosures affect their ability to run their business (for instance they have to list key people and outline some details of their employment contracts), raise assets (the financial planning community may be deterred from recommending hedge funds) and protect their investment strategy (disclosure of instruments and use of leverage may give competitors some insight as to their strategy).

Undoubtedly ASIC would have considered all these issues and felt that the possibly unfavourable implications for some in the investment community were more than offset by the overall improvement in disclosure for end investors.