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Dear Maan

Submission on Draft Regulatory Guide 97 (issued in July 2015)

The purpose of this submission is to provide feedback on the latest draft 'Regulatory Guide 97 - Disclosing fees and costs in PDSs and periodic statements' released on 28 July 2015.

It is pleasing to see that some important issues have been resolved in the current draft, including more clarity on a number of issues, but some important issues have not been addressed, as follows:

1. We do not agree with the inclusion of amounts to build up the operational risk financial reserve (ORFR) requirement in indirect costs (RG 000.123 and RG 000.172). Indeed these two paragraphs are inconsistent with RG 000.171 and RG 000.173. For the many reasons explained in our letters of 5 March 2012, 20 December 2013, 23 October 2014, 18 December 2014 and 6 March 2015, we do not believe that any transfers to reserves are costs which reduce "the return on the product or option" (which is the premise of draft RG 000.123). Instead we support separate disclosure of all transfers to and from reserves and disclosures in respect of Corporations Regulations 7.9.37 (1) (l) and (m) (as well as (k)).
2. Current disclosure requirements for indirect costs do not require trustees to split out indirect costs relating to administration, investments and advice. Such a split is imperative for members to understand what they are paying for these three very different services. This change could be achieved simply by splitting out 'administration indirect cost ratio', 'investment indirect cost ratio' and 'advice indirect cost ratio' as items (h), (i) and (j) in RG 000.143. Separating these three costs would be consistent with APRA's Reporting Standards (eg. SRS 702.0) and would also greatly assist members for whom the vague concept of an indirect cost is meaningless as it begs the question – 'what is this cost for?'
3. The proposed introduction in periodic statements of the new term 'indirect fees' alongside 'indirect costs' (RG 000.169-170) will lead to further confusion for members. It would be simpler and far more meaningful to include interposed indirect charges in 'investments fees' or 'investment fees and costs' which is consistent with how these charges are shown in Product Disclosure Statements (and recognises our previous recommendation).

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4. The new Regulatory Guide (eg. RG 000.124(b)) and Class Order (Clause 4 (j) (b)) seem to require that most investment costs should be included in investment fees, with the exception of the costs of interposed vehicles (base and performance fees) that are indirect costs. If this is the intention, it needs to be made clearer.
5. Likewise, in RG 000.83 a clear distinction has been made between performance fees deducted in interposed vehicles (included in indirect costs and based on last financial year) and performance fees deducted from other managers (included in investment fees and disclosed on a current basis). This means that some performance fees are based on last year's actual fees and others on a current basis. It appears this has been done to align the disclosure requirements for all indirect costs (administration and investment) that require disclosure of fees for the last year. But the result is that some performance fees use last year's actual fee and others use the current year basis. This is far from ideal. In our submission to Treasury of 18 August 2015 we recommended that investment performance fees should be disclosed for each of the last three years. We believe this would be more helpful and less confusing for consumers. However if ASIC generally prefers the disclosure of performance fees on the current basis, it could specifically require the performance fees for interposed vehicles to be based on the current basis, but allow the use of last year's fees where this is not available.
6. Whilst further clarity has been provided on estimating indirect costs (RG 000.60-63) and it is stated that it is 'good practice' for a fund to disclose its procedures for estimating these costs, in our view such disclosure should be mandatory so that members can determine whether the estimates provided by their fund are reasonable.
7. RG 000.124(b) specifies that fees include investment fees that are charged as a reduction in unit price, but since many not-for-profit funds use crediting rates rather than unit prices, 'or crediting rate' should be added after 'unit price' in this sub-clause.

Finally, while RG 000.126 and Example 14 go some way to address the issue of disclosing fees gross of income tax, we believe it would be helpful if RG 000.126 required that all fees are shown on a gross of income tax basis and to include a clear definition of 'gross of income tax'. We suggest the following definition for 'gross of income tax', which incorporates much of the content of Example 14 but is framed in terms of a definition rather than just as an example:

"A fee or cost that is gross of income tax is a fee or cost before adjustment for the income tax deduction the trustee may be able to claim in respect of the expenses that relate to the fee or cost. For example, assuming an income tax rate of 15% and that all expenses relating to the fee are deductible to the fund:

- (a) if a gross of income tax fee of \$100 is charged to the member's account and the tax on contributions is reduced by \$15, the amount the trustee must disclose is \$100, rather than \$85 which is the net cost to the member after allowing for the tax deduction, or



(b) if a net of income tax fee of \$85 is charged to the member's account and tax on contributions is not adjusted for the tax deduction in respect of the expenses relating to this fee, a gross of income tax fee of \$100 must be reported.

Any benefit of an income tax deduction relating to a fee or cost can be passed on to the member through the deduction of a lower fee or cost than is disclosed or as lower tax on contributions or income."

This definition should also be included in Schedule 10 so that the various disclosure requirements are consistent.

The Actuaries Institute

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Please do not hesitate to contact the Chief Executive Officer of the Actuaries Institute, David Bell (phone 02 9239 6106 or email david.bell@actuaries.asn.au) to discuss any aspect of this submission.

Yours sincerely

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