



ASIC

Australian Securities & Investments Commission

REPORT 457

Response to submissions on draft Regulatory Guide 97 Disclosing fees and costs in PDSs and periodic statements

November 2015

About this report

This report highlights the key issues that arose out of the submissions received on the draft version of Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97) and the proposed amendments to Class Order [CO 14/1252] *Technical modifications to Schedule 10 of the Corporations Regulations*, and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97).

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A Overview/Consultation process

About our consultation process

- 1 We released a draft version of Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements* (draft RG 97) on 12 December 2014, along with a request for comment in Media Release (14-334MR) *ASIC class order clarifies fee and cost disclosure requirements*. We sought feedback from industry on the key proposals and revisions outlined in draft RG 97.
- 2 Draft RG 97 incorporated amendments made necessary by the Stronger Super reforms and explained, for superannuation and managed investment products, the key fee and cost disclosure requirements of Schs 10, 10D and 10E of the Corporations Regulations 2001 (Corporations Regulations), as clarified in Class Order [CO 14/1252] *Technical modifications to Schedule 10 of the Corporations Regulations*.
- 3 We received 15 submissions from industry in response to draft RG 97. In addition, we held various meetings with respondents to discuss the proposed changes.
- 4 Subsequently, in May 2015, we consulted with those entities that made submissions on draft RG 97 on further amendments to [CO 14/1252]. We received seven additional submissions and held further meetings with industry.
- 5 In July 2015, further amendments to [CO 14/1252] and RG 97 were sent to industry for final consultation. We received another 16 submissions. In addition, we held several meetings with individual respondents and two roundtables with multiple respondents.
- 6 This report outlines the key issues and comments raised by industry in the submissions received on draft RG 97 and the proposed amendments to [CO 14/1252], and our responses to those issues and comments.
- 7 This report is not intended to be a comprehensive summary of all responses received, nor is it a detailed report on every question for which we sought feedback. We have limited this report to the key issues.

Responses to consultation

- 8 We received one or more submissions from each of the 19 respondents in response to draft RG 97 over the course of the various consultation periods, with the final opportunity for written submissions formally ending on 25 September 2015. Submissions were received from superannuation fund

trustees, managed investment product issuers, law firms, compliance consultants and industry associations. A list of non-confidential respondents is available in the appendix.

- 9 This report highlights the key issues that arose out of the submissions and our responses to those issues. The responses from the consultation process assisted us in considering amendments to [CO 14/1252], as well as finalising our guidance in the updated RG 97.

Issues to note

- 10 The objective of updating RG 97 and [CO 14/1252] is to provide guidance and clarify existing requirements and not to create new policy or materially change disclosure obligations.
- 11 Many of the submissions raised issues outside the scope of ASIC's work regarding the regulations arising from the Stronger Super reforms—in particular, respondents were concerned about:
- (a) the different treatment of registered managed investment schemes compared to superannuation entities on several issues; and
 - (b) fees for superannuation products, including amounts to cover costs incurred by the superannuation entity and amounts payable to the superannuation fund trustee for their services.
- 12 Generally, the submissions supported further clarity and guidance about fees and costs disclosure to promote consistency and ensure fees and costs taken out in investment vehicles used by superannuation entities and registered schemes are disclosed.
- 13 Many of the submissions expressed concern about the complexity of some of the drafting of [CO 14/1252], in particular of the 'interposed vehicle' definition. There was also concern about the difficulty of applying the provision for including amounts for derivative financial products as 'costs'. In response, we simplified the operation of the requirements to make it easier for an issuer to determine what must be included. We have also provided industry with a 12-month transition period to comply with the clarified requirements. During this time we will continue our dialogue and liaison with industry to help them comply with updated RG 97 and the disclosure requirements set out in amended [CO 14/1252].

B Update to Regulatory Guide 97

Key points

This section outlines the key issues raised by respondents—and our response to those issues. It covers:

- the complexity of the definition of ‘interposed vehicle’;
- other concerns about the definition of ‘interposed vehicle’;
- over-the-counter (OTC) derivatives costs;
- the requirement to reasonably estimate costs that are not known;
- the disclosure of fees gross or net of tax;
- the inclusion of the operational risk financial requirement deductions in the indirect cost ratio;
- disclosing fees and costs for a stapled security;
- the inclusion of additional voluntary information;
- performance fees;
- insurance disclosure;
- the ability to rely on the website updating mechanism in Class Order [CO 03/237] *Updated information in Product Disclosure Statements*;
- indirect fees in periodic statements; and
- the transition period.

Complexity of definition of ‘interposed vehicle’

- 14 The proposed amendments to [CO 14/1252] modified the definition of ‘indirect costs’ and ‘management costs’ to make clearer which costs are relevant. A key component of the indirect cost definition is the concept of ‘interposed vehicle’.
- 15 Many of the submissions expressed concern about the complexity of the drafting of the interposed vehicle definition in [CO 14/1252], and that it may be inconsistently applied by industry participants. Further guidance on exactly what an ‘interposed vehicle’ is was requested, as inconsistency would negate the efforts of consumers to accurately compare costs of superannuation or managed investment products.
- 16 Some submissions suggested that a principles-based approach was required, rather than a detailed description. Other submissions provided their own examples of an ‘interposed vehicle’ definition.
- 17 The draft RG 97 included a number of examples of interposed and non-interposed vehicles to assist industry in its understanding and application of

the definition. Most respondents requested more examples, particularly for complex structures, as well as the reasoning for ASIC's position on each issue.

- 18 Further explanation was also sought about why certain listed vehicles, apart from those that predominantly invest in securities or other financial products, are not interposed vehicles. Some respondents were concerned this may promote a change in fund behaviour to move from unlisted to listed vehicles.

ASIC's response

We have significantly simplified the drafting in [CO 14/1252].

We have provided further guidance, including a flowchart, explaining the application of the interposed vehicle definition, and more examples to assist in the application of this definition. Where examples are provided, further explanation has been provided outlining the basis for our position.

We consider that it is not adequate to provide a broad principles-based description of 'interposed vehicle', because the potential for inconsistent application of the definition would be worsened.

We have removed the distinctions between listed and unlisted entities in the Product Disclosure Statement (PDS) test in the definition in [CO 14/1252], which is based on what may be reasonably regarded from the PDS. We have also included further explanation of the ways in which listed and unlisted vehicles can be assessed as potential interposed vehicles in updated RG 97.

We will continue our dialogue and liaison with industry to help them follow the guidance in RG 97 and meet the requirements in [CO 14/1252] where difficulties may remain.

Particular concerns with the definition of interposed vehicle

- 19 The definition of interposed vehicle in the proposed amended [CO 14/1252] provided for an entity to be an interposed vehicle if it is not offered through a platform arrangement (the platform test) and:
- (a) has at least the 70% of its assets in relevant securities and financial products (the assets test); or
 - (b) could be reasonably regarded as a means by which the benefits of investments by or through the body are obtained (the PDS test).
- 20 Concerns were raised about each of these elements, particularly that:
- (a) ascertaining and monitoring the assets of (potentially very numerous) entities into which investments were made could be burdensome;

- (b) the PDS test could be gamed by stating that particular investments were the end investment; and
- (c) people choosing superannuation funds would not in many cases understand that fees and costs for platforms do not include fees and costs in investments that may be acquired through the platform on member instructions.

- 21 There was particular concern about the way in which fees and costs for superannuation platforms would be disclosed if entities issuing financial products selected from an investment list were not treated as interposed vehicles. Submissions emphasised the risk that retail clients would not fully consider the combined effect of costs incurred for acquiring the investments selected by the client and the costs that are incurred in those investments in making returns. Questions were raised about whether meeting the minimum requirements proposed would adequately promote consumer understanding.
- 22 A related concern was that inappropriate comparisons could be drawn between costs for investment options in superannuation funds that operate as platforms and others funds.

ASIC's response

Assets test

In applying the assets test, issuers will need to ask if they believe or have 'reasonable grounds to believe' that the vehicle has more than 70% of its assets invested in relevant securities and financial products. This does not imply any obligation to seek additional information otherwise available to confirm whether or not an entity meets the test. Having undertaken an assessment, reassessment would not ordinarily be required while an investment is held, unless new information has come to light that could change the belief. We have included additional guidance confirming this in updated RG 97. We do not consider that the requirement is unduly burdensome.

PDS test

We have included guidance to make it clear that merely stating that an entity is an end investment, and not a means to obtaining benefits from investment made by or through the entity, will not ensure that the entity is not an interposed vehicle on the basis of the PDS test. The question should be assessed from the perspective of what retail clients reading the PDS could consider. Issuers also need to ensure they meet their general PDS disclosure obligations and are not misleading. We will monitor attempts to game this test and consider exercising stop-order powers where appropriate.

Platform test

We consider that investors reading a PDS, including people choosing superannuation funds, would not reasonably regard

investments held through a platform as merely a means by which the investments made by or through the platform are obtained. As the investments are made on the instructions of the client, they are the investment of the platform. This is consistent with the requirements of s1012IA of the *Corporations Act 2001* (Corporations Act) and relevant ASIC class orders and policy (e.g. Class Order [CO 06/636] *Superannuation: Delivery of product disclosure for investment strategies*). As the drafting of the definition would include entities (such as investment trusts) as interposed vehicles to maintain the existing requirements, an exclusion has been inserted in [CO 14/1252] for platforms.

We think it is important for the issuer to make it clear to investors that they need to consider the effect of fees in the investments on which they give instructions, and we have included guidance encouraging the provision of additional information covering the cumulative impact of fees for each investment that can be selected. We also recognise the risk that investors might be misled if fee and cost figures for platforms are compared with other products, and have included guidance to avoid this in updated RG 97.

Further, we have provided guidance indicating that it will help ensure that a PDS is not misleading if an example is given illustrating the combined effect of fees and costs of the platform and of an actual or hypothetical entity that may be regarded as typical, in terms of its fees and costs and investment strategy, for a major proportion of the investments selected by investors in the relevant platform.

We will monitor industry's response to this guidance and consider whether further guidance or changes to requirements for platforms is warranted to ensure that investors using platforms understand the cumulative impact of the fees of the investments offered through platforms.

OTC derivative costs

- 23 In the proposed amendments to [CO 14/1252] we included provisions that costs associated with transactions in OTC derivatives and similar financial products form part of the indirect costs for superannuation and managed investment products. This applied for managed investment products even if the cost could otherwise have been treated as 'transactional and operational costs', which are generally not required to be included in calculating management costs.
- 24 For managed investment products, the proposed amendments to [CO 14/1252] did not require costs to be included where the derivative is used for hedging purposes. Costs that would be transactional or operational costs in relation to the ultimate reference asset underlying the derivative may also be excluded. This is because these costs are excluded from the management costs under cl 102(2) of Sch 10 to the Corporations Regulations.

- 25 Some respondents did not support the inclusion of these costs on the basis that the costs were not incurred inside an entity and that the derivative itself could be seen as the investment of the superannuation entity or registered scheme. Further clarification of the basis for including these costs was sought.
- 26 Some respondents argued that the hedging exclusion should be extended to superannuation products.
- 27 Many respondents noted practical difficulties in determining costs for derivatives based on the buy–sell spread for the derivative, noting that for many of the derivative financial products the counterparty may not offer any ongoing quote about closing out the product. This amount may not be readily ascertainable because the counterparty to the derivative is likely to be unwilling to disclose such costs, given the commercially sensitive nature of such arrangements.
- 28 Some submissions asked for clarification about how the required calculations could occur when there is a short position or multiple reference assets.

ASIC's response

Derivative financial products can provide exposure to underlying assets. As they are a means by which the benefits of exposure to those underlying assets is obtained, like an interposed vehicle, indirect costs should include any costs of obtaining that exposure. This removes any unnecessary distortion of the costs arising from the means of obtaining the exposure.

The basis for the hedging exclusion for managed investment products is that entering a derivative for hedging purposes is not a means of gaining exposure to the assets that the investment strategy calls for and therefore a means of achieving the objective of the strategy. As such, it can properly be seen as a transactional or operational cost. However, for superannuation products there is no exclusion in determining costs for transactional and operational costs.

Generally for derivative financial products other than options, when determining payments based on the reference asset certain elements of the cost will be apparent in the form of a fee or adjusted amount. However, we accept that it may not always be easy to reasonably estimate the element of the cost that reflects a buy–sell spread on the derivative financial product. We have addressed this by giving guidance in updated RG 97 that this estimate may be made based on a conventional amount for the relevant kind of derivative.

Further, we have included in [CO 14/1252] a provision that where if the issuer does not know the amount and ought not to know the amount, and the issuer does not believe they can reasonably estimate it without taking steps they consider unreasonable, they

can use either the minimum amount they can identify or 0.1% per annum of the value of the ultimate reference asset, whichever is higher. For options, this is subject to the amount of the premium being the maximum.

We have also included provisions in [CO 14/1252] covering short positions and multiple reference assets, supported by guidance in updated RG 97.

Requirement to reasonably estimate costs that are not known

- 29 The proposed amendments to [CO 14/1252] modified the definition of ‘indirect costs’ to include any amount that the issuer may reasonably estimate will directly or indirectly reduce the return on the product or option that is paid from, or the amount or value of, the income of or property attributable to:
- (a) the product or option; or
 - (b) an ‘interposed vehicle’ in or through which the property attributable to the product or option is invested.
- 30 Some submissions sought further guidance about what we would expect in terms of producing a reasonable estimate. Respondents had concerns about the practical difficulties of quantifying costs where layers of interposed vehicles were evident, particularly where the underlying investment managers were offshore or not compelled to provide cost information.
- 31 Some respondents were supportive of the proposal that issuers reasonably estimate costs. It was also suggested, as a matter of good practice, that issuers should document the procedures for making reasonable estimates of costs.
- 32 Some submissions raised concerns about the requirement to make prospective estimates for costs that are included in fees for superannuation products or management costs for managed investment products, as the determination of these amounts may be uncertain and trigger PDS updating obligations as reasonable estimates change.

ASIC’s response

In updated RG 97 we have provided guidance that we will accept that an estimate is a reasonable estimate if the issuer has taken reasonable steps to formulate it. We do not think that forming a reasonable estimate needs to involve undertaking analysis or inquiries that are costly relative to their likely impact on the fee and cost amounts.

We have included guidance encouraging documentation and publication of policies for estimating costs. We encourage

industry to develop standards for these policies to promote consistent and accurate disclosure at the lowest cost.

We have amended [CO 14/1252] so that, except for new products, costs other than the issuer's own fees (or estimates of certain performance fees) are to be based on what is known or ought to be known or, if no amount is known or ought to be known, a reasonable estimate based on the previous financial year.

Disclosure of fees gross or net of tax

- 33 A number of submissions considered that we should clarify that all fees should be shown on a gross of income tax basis.

ASIC's response

We have noted in updated RG 97 that disclosed amounts of fees and costs for a superannuation product should be shown as the total amount charged, even if the cost borne by a member is reduced by the trustee passing on to the member the benefit of an income tax deduction that the fund may receive.

Inclusion of operational risk financial requirement deductions in the indirect cost ratio

- 34 A number of submissions disagreed that operational risk financial requirement deductions from crediting rates, unit prices, fund assets or investment returns should be recognised as a fee on the basis that the fund retains the benefit of reserves.

ASIC's response

Although the amounts deducted are retained in reserves by the fund, they are nevertheless costs that reduce the returns to the member and so are properly recognised as costs. We have included a provision in amended [CO 14/1252] to allow the relevant deductions, or any other indirect costs that are not paid out of the superannuation entity, to be treated as one of the relevant fees disclosed for the superannuation product or, if the superannuation fund trustee elects, as indirect costs.

Disclosing fees and costs for a stapled security

- 35 In draft RG 97 we indicated that it is good practice for all fees and costs information for the registered scheme and body corporate security components of a stapled security to appear in a single fees and costs

calculation section. We proposed that a breakdown of these fees and costs may be provided in the 'Additional explanation of fees and costs' section of the joint PDS/prospectus.

- 36 Minimal feedback was received on this point, with mixed views on whether fees and costs should be combined for stapled securities. However, it was agreed that where fees and costs for stapled securities are required to be disclosed on a combined basis, these fees and costs should also be disclosed on a separate basis for transparency.

ASIC's response

Given the limited response to this issue, we consider that there is broad acceptance of fees and costs in stapled securities being disclosed in a single fees and costs section. We will maintain our guidance that these costs should be broken down and disclosed on a separate basis for additional transparency.

Inclusion of additional voluntary information on related parties

- 37 In draft RG 97 we encouraged issuers to include additional information in the breakdown of fees and costs to explain the basis for any amounts paid to related parties. We consider that this information could be included as a note or as part of the information under 'Additional explanation of fees and costs'. It was also suggested that this information could form part of an issuer's conflicts of interest management policy.
- 38 There were mixed views about ASIC encouraging disclosure under 'Additional explanation of fees and costs' to show any amounts paid to related parties. Some respondents sought further clarity on how disclosure of these fees and costs would be relevant to the conflicts of interest management policy.

ASIC's response

It is relevant for retail clients reading the PDS to understand the extent to which the costs they bear are attributable to benefits retained by the issuer or its related bodies. We do not encourage lengthy disclosures but only disclosure of key matters.

Issuers who have an Australian financial services (AFS) licence must have adequate arrangements to manage certain conflicts of interest in relation to the financial services they provide under that licence. In particular, for responsible entities of registered schemes, this includes the operation of the scheme.

Arrangements for the provision of products or services from related parties can give rise to a conflict of interest. Disclosure concerning situations of potential conflict may help provide a measure of accountability, and can often be a part of adequate arrangements to manage conflicts of interest.

Performance fees

- 39 Issuers of managed investment products must consider typical ongoing fees and costs in formulating the example of annual fees and costs. In draft RG 97 we indicated that the previous financial years' results will not necessarily be an appropriate basis for determining the typical ongoing amount.
- 40 Some respondents suggested that past performance fees should be a valid starting point, with adjustments made to estimates based on more recent data averaging the past three years performance fees.

ASIC's response

We accept that reviewing prior years' performance can form part of a basis for an estimate, provided it is not the sole criterion for the estimate. The estimate should take into account the investment strategy for the fund and expectations that may likely be held about the returns. The issuers' expectations about the returns, the expectation that they may give to retail clients about the returns and the performance fees over the coming period should be consistent.

Insurance disclosure

- 41 In draft RG 97 we proposed that industry attempt to implement or adopt a common method of disclosing insurance information, and we indicated that we expect information about the premium for age will relate to the member's current age.
- 42 The majority of respondents were supportive of additional clarity in the disclosure of insurance information. However, most respondents considered that a separate consultation process that leads to additional guidance on insurance disclosure is needed. A number of respondents requested more prescriptive guidance on the occupational loadings and other matters.
- 43 Respondents also recommended that we provide additional examples to assist industry in dealing with the complexities of insurance arrangements, as well as examples that demonstrate appropriate insurance disclosure. A number of respondents indicated that disclosing in a PDS all possible combinations that apply to members is not practicable. One respondent suggested that consideration be given to an insurance disclosure template.

ASIC's response

We recognise that currently insurance disclosure remains inconsistent and does not facilitate meaningful comparison for

consumers. We encourage industry to adopt standards or common methods of disclosing insurance information. Further review work may be undertaken in relation to insurance and insurance disclosure, and we will discuss these issues with industry.

Reliance on the updating mechanism in [CO 03/237]

- 44 Various submissions discussed whether [CO 03/237] is intended to apply to shorter PDSs, given that shorter PDSs cannot issue a supplementary PDS (but must instead issue an updated replacement PDS). Industry considered that [CO 03/237] was a useful and practical method by which an issuer can make the updated information available without having to issue a replacement or supplementary PDS, in circumstances where the information is not materially adverse.

ASIC's response

We accept that issuers currently make non-materially adverse changes to shorter PDSs by making the update in accordance with [CO 03/237]. We will consider whether this is appropriate when that class order is reviewed before it sunsets under the *Legislative Instruments Act 2003*.

Indirect fees in superannuation periodic statements

- 45 Under the enhanced disclosure fee regulations, indirect costs must be disclosed for superannuation products, as well as fees shown as transactions in member's accounts and the total amount of fees (reflecting other fees set out in the statement), but there is no detail as to how fees that are not deducted as transactions from members' accounts should be shown. We included a provision in the proposed amendments to [CO 14/1252] for these fees to be disclosed under a heading 'Other fees', with relevant wording to clarify the nature of the fees described.
- 46 A number of submissions expressed concern that these other fees were not permitted to be included in indirect costs. Submissions noted that this would be a change in practice that would require IT system upgrades. It was suggested that, as there is no item for these other fees or indirect fees to be disclosed as such in the PDS, this would lead to confusion for investors when comparing the fees and costs disclosed in a PDS with those in the periodic statement.

ASIC's response

As it was an intentional policy of the Stronger Super reforms that costs incurred in the superannuation entity be disclosed as a fee, it would not be appropriate for some of these fees to be merely included as indirect costs in the PDS. It is important that the indirect costs are reported to investors on the periodic statements in the same manner as these costs are disclosed in the PDS. This facilitates investors' understanding and ability to reconcile the indirect costs borne by them with the expectation set by the PDS about what will be charged.

We acknowledge that it would be desirable to align the disclosure concerning fees with the categories of fees in the PDS, and we encourage superannuation trustees to do so in the periodic statement—for example, by breaking down direct fees and other fees by investment fee and administration fee. As there is no specific requirement for this in the enhanced fee disclosure regulations, to address respondents' concerns about comparability we have included standard wording about other fees (i.e. those not charged directly as a transaction) to cover the disclosure of those other fees. This is in line with the objectives of the regulations, which require that the total fee and costs be disclosed and that the total reflects the sum of fees and costs disclosed in the statement, given that it would be misleading to refer to a total fee that does not include any of the fees and costs recognised for PDS disclosure.

Transition period

- 47 A key area of concern among a number of respondents was the proposed transition period for [CO 14/1252]. There were various suggestions on an appropriate timeframe, with submissions proposing start dates:
- (a) for PDSs—ranging from 1 January 2016 through to 1 October 2018, and possibly until January 2019 to avoid the possibility of issuers having to roll over again in October those PDSs that would be updated as at 1 July of the same year. Respondents proposed extended transition periods predominantly to reduce the costs incurred by industry in rolling over disclosure documents outside the normal roll-over cycles; and
 - (b) for periodic statements—from 1 July 2017 to as late as 1 January 2018 for exit statements issued on or after that date.

ASIC's response

We have offered transitional provisions that ensure no change applies in relation to PDSs until 1 February 2017, which is over 14 months after publication of updated RG 97 and the amended [CO 14/1252]. Requirements for periodic statements will apply to

statements given on or after 1 January 2018. These transitional provisions should minimise the need for additional PDS roll overs.

We expect to review compliance with the new requirements after the end of the transition period. We may also take steps to enforce current requirements during the transition period where we identify non-compliance.

Appendix of non-confidential respondents

- Actuaries Institute
 - Alternative Investment Management Associations
 - Association of Superannuation Funds of Australia
 - Australian Institute of Superannuation Trustees
 - Australian Private Equity & Venture Capital Association Limited
 - C-bus
 - Chant West
 - Corporate Super Association
 - Financial Services Council
 - Industry Super Australia
 - Law Council of Australia
 - PMC Legal
 - Property Council of Australia
 - Superannuation Compliance Services
 - Towers Watson
-