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Email: feeandcostdisclosure@asic.gov.au

Copy: Mr Jerome Davidson and Ms Michelle Calder, The Treasury (*the matters relate to managed investments and superannuation*)

By email only

Dear Maan

FSC comments on the 24 September 2014 (as amended 9 October 2014) ASIC draft fee and cost disclosure Class Order

We thank ASIC for providing FSC with the opportunity to comment on the 24 September 2014 draft class order (the "**Class Order**"), as marked up by ASIC on 9 October 2014. We also refer to our 26 August 2014 submission in relation to an earlier targeted consultation draft of the Class Order – many of our comments in our 26 August 2014 submission apply equally to the 24 September 2014 draft of the Class Order. This 22 October submission should be read along with our 26 August 2014 submission (for brevity we have not repeated all our comments in our 26 August 2014 submission).

Our submission is in five sections:

In **Section 1** we provide General Comments on the Class Order. In **Section 2** we set out some (but not all) issues with the fee regulations which the Class Order does not address but which should be considered, perhaps as part of a Treasury led holistic review of the fee regulations we commend. In **Section 3** we respond to some of ASIC's specific consultation questions (set out in ASIC's 24 September 2014 *Proposed Class Order: Schedule 10 technical amendments)*. **Section 4** sets out a sample of costs if ASIC continues to insist on (existing and other) PDSs complying with the Class Order (which has not yet been finalised) by 1 July 2015. FSC previously submitted to ASIC the need for a reasonable transition period. In our view a 1 July 2015 start date is unreasonable, given the cost impacts on industry of out of cycle PDS rolls amounts to millions of dollars. ASIC's proposed timetable imposes unnecessary costs on industry which cannot be supported by any countervailing benefit/policy rationale. **Section 5** sets out our suggested approach instead of proceeding with the Class Order (other than some of the simple aspects of the Class Order which we support).

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Section 1 - General Comments on Class Order approach

1. FSC supports effective and clear fee disclosure. While we welcome ASIC seeking to respond to industry comments and clarify aspects of the fee regulations (such as concerns about double counting, and to remove references to "negotiating fees with your employer" when clearly not relevant in the Consumer Advisory Warning), the FSC considers that the fee regulations should be reviewed by Treasury (consulting with ASIC, industry and other stakeholders) after the Government's response to the Financial System Inquiry has been issued.

2. We consider a holistic review of the fee regulations is required. Other than correcting anomalies in the Consumer Advice Warning, removing double counting in the ICR for superannuation products and our comments on switching fees, FSC disagrees with the fee regulation provisions being amended by ASIC (via a Class Order) as opposed to by the Executive (via regulations). We do not support the Class Order option as the means of refining the fee regulations (other than correcting the simple matters above, in recognition of the exigencies of other Government priorities).

3. Our consultation with our members on the Class Order evidences that the complexity of the fee regime is not easily dealt with via written submissions on a draft Class Order. Our members seek an industry wide Round-table, to which industry at large is invited, along with other interested groups. The Round-table should ideally be chaired by Treasury, with ASIC, industry and other stakeholders in attendance. The risk with using a Class Order to "fix" some of the issues with the fee regulations is that, shortly afterwards, other amendments may be required under the Financial System Inquiry reforms, to address further changes to the fee regulations – this would then result in industry being required to implement multiple sets of changes of fee regulations.

4. In other respects (such as the Class Order definition of "indirect costs" and "interposed vehicle" and the rules regarding buy/sell spreads of derivatives) our members found the Class Order complex, ambiguous and confusing.

5. The principal reasons for difficulties with the Class Order include:

   (a) The knowledge criterion (admittedly in the current regulations for superannuation but not managed investments) is problematic as it will not achieve the objectives of:

      i. reporting of costs of underlying structures because the trustee will often not be in possession of such information; or

      ii. consistent reporting because trustees will not have uniform knowledge of underlying expenses of externally managed funds. This is potentially confusing to investors as a substantial component of underlying expenses may be disclosed in one product (where there is knowledge), but not another where there is imperfect knowledge or no knowledge.

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(b) The ASIC proposal to require trustees who do not have actual knowledge and who also ought not reasonably know the underlying fees and costs, to provide nonetheless a "reasonable estimate" of underlying fees and costs, is highly uncertain. For the Class Order to require a "reasonable estimate" of underlying fees and costs when the trustee does not even have knowledge nor ought reasonably to have knowledge creates uncertainty.

Apart from the uncertainty of applying a "reasonable estimate" when the trustee does not have the knowledge and ought not reasonably know the fees/costs of underlying vehicles, the "reasonable estimate" aspect (which under ASIC's draft Class Order only applies where the trustee has no knowledge and ought not reasonably have knowledge) may not be consistent with section 1013C(2)(a) of the *Corporations Act* which limits information required in a PDS to the *extent the information is actually known to the responsible person*. We observe that the regulations also refer to "ought to know" which is not the same term used in section 1013C(2)(a). While in certain cases the fee regulations default to estimates (e.g. clause 209(b)(iii) Schedule 10), the use of the "reasonable estimate" aspect of the Class Order (where the trustee simply does not have the requisite knowledge and also ought not reasonably to have knowledge) raises issues relating to the breadth of ASIC's Class Order power and whether or not ASIC's Class Order power extends so far as to permit ASIC to require by Class Order that a trustee provide a reasonable estimate of fees/costs that it does not know or ought not reasonably know, given section 1013C(2)(a) of the *Corporations Act* limits the PDS content requirement to the actual knowledge of certain persons. See **Appendix 1** for more information in relation to whether or not the Class Order as it relates to the requirement to provide a reasonable estimate where the trustee does not have knowledge of the underlying fees/costs (nor ought to reasonably know them) may be inconsistent with the Act.

(c) There are practical impediments on judgements to be made on assessing reasonable estimates (where the trustee has no knowledge and ought not reasonably know underlying fees and costs).

6. The proposed Class Order makes quite fundamental changes to the definition of "indirect costs", and introduces a new concept of "interposed vehicle" with implications for MySuper, Choice Super and Managed Investment Products. These are more than just "technical amendments".

7. The Class Order imposes new obligations on trustees and responsible entities (superannuation and managed investments) to know or reasonably estimate any amount that directly or indirectly reduces the return on a product, including through all interposed vehicles (and in relation to "reasonably estimate", even where the trustee does not know and ought not reasonably know the underlying costs of externally managed vehicles).

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8. The Class Order requires that where a trustee does not know the underlying fees and costs and also does not have reasonable means to know the underlying fees and costs (i.e. cannot be said to reasonably ought to know such fees and costs), that nonetheless the trustee must still provide a figure for the underlying fees and costs. This requirement is in our view particularly difficult and problematic for trustees investing via external parties/external fund managers. ASIC requires in such a case a "reasonable estimate" of a figure which by definition the trustee does not know and does not have the reasonable means to know. Such a test will not aid consistency and comparability as it is not clear how in such case a trustee is to estimate reasonably.

9. ASIC asks whether there are any unanticipated consequences from the amendments. Some are covered in this submission, and others may only emerge as funds/trusts work through the practical implications of ASIC's complex Class Order. One implication may be that various documented arrangements and various IT and management information systems may need to be amended to capture and subsequently report on the 'indirect costs' as *defined* and *expanded* by ASIC in the Class Order. (*Expansions* including treating derivative transaction costs (buy-sell spread) as an indirect cost, and requiring reasonable estimates of underlying fees/costs when the trustee does not actually know them nor ought reasonably know them.)

Derivatives

10. It is not clear why the buy-sell spread for over-the-counter (OTC) derivatives should be treated as indirect costs rather than transactional and operational costs, in direct contradiction to the definition of "transactional and operational costs" in item 103 of Schedule 10 of the Corporations Regulations 2001 (Cth). Nor is it clear what constitutes 'hedging' or why the treatment of the *transaction cost* (i.e. the in-built buy-sell spread) of a derivative changes depending on whether the derivative is used for investment or hedging purposes – the implication being that buy-sell spreads on *hedge derivatives* are *transaction costs* (which we agree with), but buy-sell spreads for *all other types of OTC derivatives are not to be treated as transaction costs* but instead to be deemed to be an indirect cost (which we disagree with).

11. A buy-sell spread for an OTC derivative reflects the cost of entering into the transaction and is built into the price of the derivative (regardless of whether or not the derivative is used for investment or hedging purposes); it is not a fee charged in addition to the cost of the transaction. In any event it would be extremely difficult, if not impossible, for a trustee or responsible entity to extract and ascertain the buy-sell spread of an OTC derivative in order to disclose it.

12. Derivatives are used for investment exposure purposes, for hedging and for other investment purposes. For example, equitising cash is a common use of derivatives for share funds. We do not agree that a buy-sell spread of a derivative is an indirect cost. ASIC's proposal to include the spreads on derivatives as an indirect cost is not appropriate.

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13. The Class Order applies the concept of a buy/sell spread to all types of derivatives not traded on a financial market (that is, to over the counter derivatives). A buy/sell spread is essentially the difference between the buy price and the sell price of an asset.

14. The application of a requirement to include in indirect costs the buy/sell spread of *over-the-counter* derivatives is problematic at best. By definition, there is not necessarily a market to trade over-the-counter derivatives. Accordingly, it is extremely difficult, at the time of entering into (i.e. "buying") an over-the-counter derivative to value the derivative at the time of a hypothetical sale of the derivative in the future.

15. FSC would be concerned with any practice where the primary or sole purpose of the use of a derivative is not for the purpose of obtaining investment exposure, or hedging or risk management or other investment related purposes, but is instead used for the primary or sole purpose of seeking to achieve the result that a fee which would otherwise need to be disclosed under the fee regime (but for the use of the derivative) would not need to be disclosed. Such practice would raise serious questions in relation to trustee and licensee duties. FSC is not aware of a market practice of using derivatives not for an investment related purpose but merely so as to manufacture a certain fee result – such a practice, if it existed, would be seriously concerning. However, if ASIC has evidence of derivatives being used not for the purpose of obtaining investment exposure, for hedging or for other investment management purposes, but instead for the pre-dominant objective of avoiding the disclosure of an otherwise disclosable fee, then we agree with ASIC's concerns (to that extent).

16. ASIC's proposal to exclude buy-sell spread on derivatives for a "hedged" position does not address the practice which should be addressed by ASIC (that is use of derivatives for the primary purpose of avoiding fee disclosure, if ASIC is genuinely of the view that such practice is occurring). Derivatives which are perfectly legitimate investment practices include equitizing cash and managing duration of fixed interest funds, and use of return swaps which give exposure to an underlying pool of assets – which are not "hedges". The buy-sell spread in such derivatives should be treated as a transaction cost, even if they are not "hedges" but a means of achieving market exposure or an investment objective.

17. If ASIC is genuinely concerned that issuers are entering derivatives for the purpose of avoiding fee disclosure (rather than for an investment management related purpose), instead of ASIC's test in clause 101A in relation to the buy-sell spread of derivatives, ASIC should adopt an anti-avoidance test. An anti-avoidance test is a more targeted test directed at the mischief ASIC is concerned about (hiding fees via derivatives). ASIC's Class Order test is a blunt instrument which treats all *transaction costs* (i.e. buy-sell spreads) of OTC derivatives which cannot be described as hedges *as instead to be treated as an indirect cost* – this approach directly contradicts the current definition of transactional and operational costs in Schedule 10.

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Anti-avoidance test – derivatives not used for investment management purposes

18. We support ASIC tackling the mischief sought to be addressed (the use of derivatives not for investment purposes but for the primary purpose of achieving an ICR fee result). ASIC should amend its current test (in the Class Order) to address the mischief, by instead providing in the Class Order that where OTC derivatives are used for the *pre-dominant or sole purpose* of avoiding disclosure of indirect costs, then the buy-sell spread of the derivative should be included in indirect costs. This would accommodate ASIC's concern which is not about the legitimate use of derivatives for investment purposes (whether for investment exposure, duration management or hedging purposes) but with the use of derivatives *for the objective of avoiding fee disclosure*. We share ASIC's concern if derivatives are being used not for investment management purposes.

Transition period

19. If ASIC proceeds with the Class Order, a reasonable transition period should apply. In our 26 August 2014 submission on the targeted consultation of an earlier draft of the Class Order, FSC noted that a reasonable transition period should apply and that any changes should only apply to PDSs issued on or after a certain date. ASIC has not agreed. If ASIC proceeds with its decision in relation to requiring all PDSs to be updated for the Class Order by 30 June 2015, this will result in unscheduled product rolls which costs industry millions of dollars as ASIC would be aware. Some cost data is set out later in this submission. To avoid this additional cost burden imposed on industry, only a *superannuation PDS issued on or after 1 July 2015* or a *managed investment PDS issued on or after 1 July 2016* should be subject to the amendments outlined in a finalised Class Order. These requested start dates are on the assumption the Class Order route proceeds and is finalised shortly. If ASIC adopted a transition which applies to PDSs issued *on or after* these dates, ASIC would be contributing to the Government's red-tape reduction initiatives (with no apparent consumer detriment in doing so).

20. As noted elsewhere in this submission, as a general principle we do not consider that changes to the fee disclosure regulations should be made by ASIC Class Order as we consider this should be a matter for regulations and consultation by Treasury/Government in accordance with Treasury/Government priorities (we do appreciate that Treasury/Government has other pressing priorities). However if ASIC proceeds by Class Order with the managed investments changes, the changes should only apply to managed investments PDSs issued on or after 1 July 2016.

21. However, a trustee or responsible entity should be permitted (but not required) to adopt the amendments in the Class Order at such earlier date as it determines (if ASIC proceeds with a Class Order).

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Magnitude of the changes to managed investments

22. The proposed Class Order is making fundamental policy changes to the managed investments fee disclosure regime – changes not made by the *Superannuation Legislation (MySuper Measures) Amendment Regulations 2013* (made 28 June 2013). Such changes should be undertaken via a Treasury led consultation. Until such time as a Treasury led consultation on the fee regulations may occur we consider that ASIC should *not* be amending by Class Order the managed investments fee disclosure regime (other than the simple changes relating to the Consumer Advisory Warning and our comments on switching fees). We make the same point above in relation to the fee regulations as they relate to superannuation, but this applies with even greater force to managed investments given the impact on the managed investments regime of the ASIC Class Order.

Interposed Vehicle

23. The "interposed vehicle" definition is complex – our working group consisting of very experienced product and legal professionals found the definition both unclear and confusing -– some had differing opinions on the operation of parts of the definition while there were some parts which our members were unsure what was intended.

24. Even if constructive knowledge is appropriate, it is unclear as to the extent to which a trustee is required to or ought to "drill down" through a chain of underlying externally managed vehicles.

25. ASIC's definition of "interposed vehicle" is unclear for the following reasons:

    (a) it is not known what types of entities should be looked through;

    (b) given current industry practice is not to provide this type of fee and cost information, it is not known how a trustee could reasonably obtain the fees and costs information from a chain of vehicles – particularly a chain of unrelated vehicles. In this regard, we note that information obtained through APRA reporting is limited to related parties and the first level of an unrelated party, and information obtained through portfolio holdings is limited to information on assets (and not fees and costs).

26. It is difficult to understand how the definition of *interposed vehicle* is to apply. Some examples of difficulties created by ASIC's drafting include:

    (a) In subclause (c)(i), it is not clear what is meant by the phrase "a managed investment scheme of such a body, trust or partnership";

    (b) it is unclear the circumstances in which subclause (c)(ii) would apply. Specifically it is unclear in which circumstances (quoting ASIC's drafting) "*a body, trust or partnership or security or interest in a managed investment scheme of it, would not reasonably be*

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regarded as the means by which people holding an interest in the relevant product or option would obtain a financial return or benefit"; and

(c) ASIC's explanatory material *Proposed Class Order: Schedule 10 technical amendments (24 September 2014)* does not provide guidance in regard to the above matters to clarify what in our view was unclear in the subclause (c)(i) and subclause (c)(ii) drafting of the definition of "interposed vehicle".

Consistency with other legislation

27. We recommend that in relation to the definition of *indirect costs* ASIC leverage the concepts in the *Financial Sector (Collection of Data) Act 2001* section 13(4A) where the phrase "assets derived from assets" of a registrable superannuation entity is used. Section 1017BC(1) of the Corporations Act uses a similar concept of assets derived from assets of the entity. This is a simpler and clearer term and is already being applied by the superannuation industry in their reporting to APRA. If the Class Order proceeds, we consider that this terminology should be considered for adoption in the fee Class Order (as an alternative to the current complex drafting of *indirect costs*) for consistency and clarity. (To be clear, our concerns with the concept of *reasonable estimate* where the trustee does not have knowledge and cannot be said to ought reasonably have knowledge of underlying fees/expenses, would remain irrespective of the drafting of *indirect costs*.)

28. Further, the *indirect costs* of underlying investments should be disclosed on the basis of what a retail investor would pay in *indirect costs* if they had invested directly in the underlying investment. This concept is already used in the new clause 102(2)(h) of Schedule 10 in relation to managed investments where the following costs are *not* captured in management costs (for managed investment schemes) in terms of delineating between management costs (for managed investment schemes) and (transaction) costs of investing in the underlying investment:

> *"(h) costs (related to a specific asset, other than a right or holding in an interposed vehicle, or activity to produce income) that an investor would incur if he or she invested directly in the asset".*

29. That is, the principle should be that, for *indirect cost* disclosure, the trustee should have primary regard to what the operator of that underlying investment would disclose to a retail investor as *indirect costs* and therefore what the trustee can then obtain by way of PDS or other regulated disclosure (of *indirect costs*) by the underlying manager.

Indirect costs - References in Class Order to "reasonably estimate" may be beyond the Class Order/modification power

30. The proposed clause 101A(1) may be beyond power in its current form and accordingly, may be "read down" to exclude references to "reasonably ought to know" (albeit that phrase is

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also currently used in the regulations for superannuation but not for managed investments) and "may reasonably estimate" for the reasons canvassed below.

31. It also follows that under the definition of "indirect costs" in existing clause 101 of Schedule 10 of the Corporations Regulations, only indirect costs actually known to the issuer would be required to be disclosed and not indirect costs which the trustee does not know but may reasonably ought to know (significantly this element of the definition would not therefore have application under the current law). (Obviously trustees cannot and should not be wilfully blind as to fees/costs of underlying investments as this would be improper as well as inconsistent with trustee duties and the obligations of an AFSL holder.)

32. In essence as section 1013C requires content which is in the *actual* knowledge of the regulated person, it is likely that a legislative instrument (such as a Class Order) mandating a reasonable estimate of indirect costs (where the trustee does not even know such costs and ought not reasonably know such costs), may be read down as set out below.

Construction of proposed clause 101A(1)

By operation of section 13(1)(c) of the Legislative Instruments Act, the Proposed Class Order must be read subject to the Corporations Act as its enabling legislation.

Clause 101A is likely to be 'read down' as follows:

101A Indirect costs

(1) The indirect cost of a MySuper product or investment option offered by a superannuation entity or managed investment product means any amount that:

(a) a trustee of the entity or responsible entity knows~~, or reasonably ought to know or, where this is not the case, may reasonably estimate,~~ will directly or indirectly reduce the return on the product or option that is paid from or reduces the amount or value of:

i. the income of or the property attributable to the product or option; or

ii. the income of or property attributable to an interposed vehicle in or through which the property attributable to the product or option is invested; and

(b) is not charged to a member as a fee; and

(c) is not a fee under section 29V of the SIS Act.

33. **Appendix 1** of this submission sets out more detail in relation to the issue we raise as to whether the proposed clause 101A(1) (inserted by Class Order) may be "read down" to exclude references to "reasonable estimate" where the trustee has no knowledge, nor ought reasonably have knowledge of the underlying fees/costs. We would be willing to share our external legal advice received from one of our members as to why the ASIC Class Order provision requiring a "reasonable estimate" (when the trustee does not have knowledge of

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the indirect costs and ought not reasonably have such knowledge) raises the issue as to whether or not that requirement is beyond ASIC's Class Order modification power, in that it is directly inconsistent with the actual knowledge PDS content test in section 1013C(2). (Obviously, a trustee/responsible entity which is wilfully blind as to fees may be acting in breach of its trustee/RE duties and various obligations of AFSL holders.)

Indirect costs definition – other comments

34. The phrase "may reasonably estimate" is very problematic. It introduces subjectivity and uncertainty to the calculation of indirect cost. We observe ASIC proposes to apply this where a trustee does not know the underlying fees/costs and could not reasonably know (i.e. could not be said to ought reasonably know the underlying fees/costs).

35. The Class Order does not address a number of the policy problems with the notion of indirect cost disclosure on a look through basis. For example:

    (a) There may be significant costs and difficulties associated with a requirement to disclose indirect costs which is not limited in some sensible way (such as looking through related entities only, similar to APRA reporting standards). This includes where interposed vehicles (unrelated to the trustee/responsible entity) are unwilling to provide detailed information on investments and costs due to their desire to keep such information confidential for commercial reasons. While this may then fall outside the "reasonably ought to know or may be reasonably estimated" test, it is not necessarily clear that they will.

    (b) In the context of superannuation funds, ICR disclosure applies to MySuper products which have been specifically designed for less engaged investors. The ICR is not necessarily an easy concept to understand nor a common one for a disengaged member.

36. While not addressing the uncertainty mentioned in paragraphs 34 and 35 above, the substitute definition of "indirect cost" in clause 1(a) of the Class Order could be shortened (our suggested changes are marked up) to read simply *'**indirect cost*** ~~*of a MySuper product or investment option offered by a superannuation entity or of a managed investment product*~~ *has the meaning given by clause 101A*.'

37. The beginning of clause 101A(1) would be more accurate if it read *'The indirect cost of a MySuper product, investment option offered within a superannuation product other than a MySuper product, managed investment product or investment option offered within a managed investment product means any amount that:*'. This accommodates both managed investment products that have a single investment strategy (i.e. thereby no 'options') and those with investment options.

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38. Difficulties of ASIC's definition of indirect costs include uncertainty in ascertaining what is *reasonable* for 'reasonably ought to know' (admittedly currently in the regulations) and 'may *reasonably* estimate' and how could this be proven?

Indirect costs definition – clause 101A(1)(a)(ii) – clarity

39. Where an interposed vehicle invests in, say listed shares (e.g. BHP), the BHP shares would be "property" of the interposed vehicle. BHP's operational costs would be an amount that reduces the amount or value of the BHP shares and therefore potentially be classified as an "indirect cost". If so, this would be unworkable. Similarly, the income or value of the real property of a REIT could be reduced by the maintenance costs attributable to any building it owns. If that is the case, it would appear those maintenance costs would be included as "indirect costs" under the ASIC Class Order. There will be other examples, but this illustrates the point that the wording potentially has the effect of capturing as part of "indirect cost" an amount reducing the profit on an asset.

Indirect cost definition – cl 101A(1), (3) and (4) – derivatives

40. We refer ASIC to our comments on derivatives in paragraphs 10 to 18 inclusive for more detail and reiterate some of our comments on derivatives below.

41. ASIC has proposed that the buy-sell spread of OTC derivatives are indirect costs. As noted above, it is unlikely to be possible to determine a buy/sell spread for an OTC derivative. Even if it were possible, the buy-sell spread is a transaction cost, a cost of investing in the derivative that is built into the price of the derivative, not an indirect cost. For example, it could hardly be said that the premium paid by a CDS buyer is not a transaction cost (of managing credit risk). It is not an indirect cost.

42. The implications of ASIC's proposal to require buy-sell spreads of derivatives (other than hedges) to be treated not as a transaction cost but as a indirect cost will be significant and may depend on the accounting treatment and management information that is associated with each derivative transaction (whether held directly or in an underlying vehicle).

43. It is unclear why buy-sell spreads for an (OTC) derivative should be included as an "indirect cost", when as a principle and under the Corporations Regulations, other transaction costs are excluded.

44. It is also not clear when a product is "hedged" or why the treatment of the transaction cost of a derivative should change depending on whether the derivative is used for investment or hedging purposes.

45. If ASIC is concerned with a particular type of arrangement, it would be better if the provisions are drafted more specifically by a different test than ASIC currently proposes. FSC supports a test (properly drafted) which captures (in indirect costs) the buy-sell spread of derivatives

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which are not entered into for investment management purposes but instead are entered into for the primary or sole purpose of avoiding fee disclosure (please refer to our comments in paragraphs 10 to 18 above).

46. ASIC's test in the Class Order is difficult as a matter of principle (treating the buy-sell spread of non-hedge derivatives as an indirect cost rather than a transaction cost) and also not practicable as there are major difficulties in obtaining buy-sell spread information.

Section 2 - Issues not addressed by the proposed Class Order amendments

47. While we consider that a holistic review of the fee regulations is preferred (rather than amendments by Class Order – other than certain simple matters addressed by the Class Order), if ASIC proceeds with the Class Order there is an opportunity to extend the Class Order amendments to address a number of other issues that have arisen as a result of the *Superannuation Legislation (MySuper Measures) Amendment Regulations 2013*. Some of these issues are symptomatic of the need for a holistic review of the fee regulations (led by Treasury) across superannuation and managed investments. Some, but by no means all, of the issues with the fee regulations are set out in paragraph 57 (*Other technical errors*).

Inconsistency of fee and cost disclosure

48. In relation to superannuation products, the definition of both "investment fee" and "administration fee" in the SIS Act, to which Schedule 10 now refers, are broad.

49. While the issue of double counting has been addressed in the Class Order, the distinction between an investment fee or an administration fee, and an indirect cost remains unclear and a number of providers in the industry have interpreted the definitions in different ways which has resulted in fees for similar products not being able to be compared on a like for like basis.

50. For example, if a superannuation product provider offers an externally managed fund to members and that fund charges a management fee to the trust, this fee may be disclosed by one provider as an investment fee in the PDS fee table, while another provider may disclose the same management fee as part of the indirect cost ratio (or possibly the other fees and costs row) in the PDS fee table of the superannuation product.

51. The other sections of this submission set out concerns in relation to the proposed wording of the Class Order. Whatever approach is finally adopted by ASIC in relation to this issue, it is important that ASIC considers the potential impact of the proposed Class Order on the ability of superannuation trustees to comply with the SIS fee charging rules in Division 5 of Part 2C of the SIS Act and the APRA reporting standards in the *Financial Sector (Collection of Data) Act 2001*.

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Periodic Statement Disclosure

52. Clause 301 of Schedule 10 requires the disclosure of 'Indirect costs of your investment' in periodic statements. For superannuation products this disclosure is problematic and potentially misleading as, in addition to those amounts caught by the indirect cost definition and therefore by definition included, this amount may also include other amounts that are not charged directly to the member's account that have not been classified under ICR in the PDS fee table. For example, investment and/or administration fees charged by a trustee and included in the unit price of the investment option:

- Will not appear in itemised transactions in the periodic statement; and
- Will not necessarily be disclosed as part of the ICR in the PDS as they could appear under investment and/or administration fees.

53. In order to rectify this issue, clause 301(1) requires amendment to replace 'Indirect costs of your investment' with a term that does not mislead members into associating this amount only with the 'Indirect cost ratio' disclosed in the PDS. A term such as the previous term 'Other Management Costs' would suffice.

54. In addition, clause 301(2)(a) that refers to an amount that should be inserted for a MySuper product or an investment option offered by a superannuation entity should be amended to align to clause 301(2)(b) for a managed investment product as follows:

> *The amount inserted must include:*
>
> (a) *For a MySuper product or an investment option offered by a superannuation entity – all fees and costs not deducted directly from a member's account during the reporting period;*

Inclusion of transaction costs in ICR for superannuation products

55. The introduction of the concept of *indirect costs* for superannuation products now means that transaction costs of the superannuation fund (where there is no buy/sell spread) and of underlying investments must be included in the *ICR disclosure in the PDS* and also in '*Indirect Costs of Your Investment' in periodic statements*. To the extent that these costs are not disclosed under buy-sell spread, they will include transaction costs associated with member cash flows as well portfolio trades initiated by the investment manager seeking to maximise returns. While estimated transaction costs as a result of member transactions may be derived from the buy/sell margin, the estimation of other transaction costs remains problematic as managed investment schemes are not required to include transaction costs in their ICR as these are specifically excluded in the definition of management costs under clause 102(2) of Schedule 10.

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56. It is not clear whether the intent of the *Superannuation Legislation (MySuper Measures) Amendment Regulations 2013* was to introduce this inconsistency whereby transaction costs are *included* in an ICR for superannuation products (to the extent that they are not otherwise disclosed in a buy-sell spread) whereas transaction costs are *excluded* in the ICR for managed investment products with the associated disclosure under 'Indirect Costs of Your Investment' in periodic statements. To bring this in line with the managed investments fee disclosure regime, either:

(a) a specific subclause should be introduced under clause 101A to *exclude* transactions costs from indirect costs of a superannuation product; or

(b) the exclusions currently in subclause 102(2) (for managed investments) should be extended to apply to indirect costs of superannuation products.

Other technical errors

57. There is a range of other technical errors that we recommend ASIC rectify if ASIC proceeds with the Class Order, including:

(a) **Clauses 202 and 202A**: Removing each reference to "insurance costs" in the second paragraph of both preambles for managed investment products;

(b) **Clause 209(j)**: Insert an exclusion so that information need not be included about transactional and operational costs in the Additional Explanation of Fees and Costs to the extent set out in the fee table;

(c) **Clause 209(m)**: Delete the reference to member protection costs given that the Stronger Super regime repealed these rules;

(d) **Clause 209A**: Clause 8(6A) of Schedule 10D permits the fee definitions to be incorporated by reference. Accordingly, ASIC's changes are not necessary. However, it is recommended that the introductory paragraph be amended to clarify whether or not the exact drafting set out in the regulations must be adopted. Note that if ASIC is of the view that exact drafting is needed, it will need to revise the definition of switching fees inserted into the list of definitions.

(e) **Clause 215**: Amend the minimum entry balance rule so that the law permits the example of fees and costs to be based on the lowest multiple that "equals" or exceeds the minimum entry balance.

(f) **Clause 220**: Amend this clause to permit the statutory fee example to be based on a large employer MySuper product.

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(g) **Clause 221(1)**: Amend the fourth paragraph of the consumer advisory warning so that it reflects the ability of members or employers to negotiate fees, and refers to the ability to negotiate investment fees and administration fees if applicable.

Section 3 - Responses on ASIC's specific Consultation Questions

58. Our responses to specific consultation questions should be read with our comments in Section 1 *General Comments on Class Order approach* and Section 2 *Issues not addressed by the proposed Class Order amendments* above. Many of our comments in these sections also apply to the specific consultation questions.

Indirect cost, double counting and switching fee

ASIC Question B1Q1: Do you agree with the provision that a trustee may reasonably estimate indirect costs when these costs are not known? If not, how do you propose that indirect costs of an investment be disclosed when these costs are not known?

59. We do not agree with a provision that a trustee may reasonably estimate indirect costs when the trustee does not know those costs. Rather if not known, then they should not require disclosure (of course we expect trustees to exercise due process and not act such as to be wilfully blind to fees they otherwise would know).

60. Views are likely to differ regarding what is reasonable. That will detract from comparability. Circumstances may also impact reasonableness. For example, it might be reasonable for a trustee that was invested through an interposed vehicle for the whole year to estimate amounts using the annual report, but not reasonable for a trustee who was invested for part of the year to estimate. Again, this will impact comparability.

61. It is not clear how a trustee could be expected to reasonably estimate an indirect cost if it does not have any information on which to base such an estimate even if it reasonably ought to know that such indirect cost exists and has taken reasonable steps to ascertain such cost.

62. This is distinct from a trustee knowing that an indirect cost exists and has historical data on which to base an estimate, in which case an estimate may be able to be disclosed based on the data even if this estimate will not reflect the actual indirect costs that will be incurred in the future.

63. Where a trustee does not know the indirect costs and cannot reasonably ought to have such knowledge, then that should be the end of the matter and therefore we do not support a requirement in such case for a trustee nonetheless to somehow ascribe a *reasonable estimate* of a cost which by definition it does not know nor ought reasonably know.

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ASIC Question B1Q2: Does the amended indirect costs definition address any instances of double counting of fees?

64. It is clear from the existing definition of indirect costs that if these costs are not otherwise charged as a fee, then they ought to be included in the indirect cost ratio and hence double counting should not occur.

65. The addition of "is not a fee under section 29V of the SIS Act" may cause confusion in relation to the interpretation regarding fees for choice products. An alternative clearer approach to avoid any doubt would be to explicitly set out a list of all defined fees that are *not* included in the definition of indirect costs. Such a list should include:

(a) Activity fees
(b) Administration fees
(c) Advice fees
(d) Buy-sell spread
(e) Contribution fees
(f) Establishment fees
(g) Exit fees
(h) Incidental fees
(i) Insurance fees
(j) Investment fees
(k) Switching fees
(l) Withdrawal fees.

ASIC Question B1Q3: Does the definition of switching fee result in instances of double counting of a fee where a switch from one product to another within a superannuation entity may be captured by another fee?

66. Subject to paragraphs 67(a) and (b) and paragraph 68 below, the revised definition of *switching fee* can now be applied consistently across MySuper products and choice products in a superannuation entity and hence there should be no instances of double counting. Please refer to paragraph 67(c) below regarding an observation relating to switches involving managed investment products. Please also refer to the table in paragraph 68 for suggested alternative definitions of *switching fee*.

Switching fee

67. The Class Order changes contemplate a much needed differentiation between MySuper products and superannuation products other than a MySuper product. However we have the following concerns:

(a) Paragraph (a) of the definition of "switching fee" which now applies to MySuper products only, refers to subsection 29V(5) of the SIS Act for the meaning. Subsection 29V(5) of the SIS Act states *'A switching fee is a fee to recover the cost of switching all*

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or part of a member's interest in a superannuation entity from one class of beneficial interest in the entity to another.' However, the meaning of the words 'one class of beneficial interest' in that definition is unclear.

(b) To ensure there is no potential double counting where a switch from one product to another product *within* a superannuation entity may be captured by another fee (e.g. exit fee), the new paragraph (b) (of the definition of "switching fee") for superannuation products other than a MySuper product, should be limited to just switches between investment options within the same superannuation product. Therefore, paragraph (b) should be changed to read *'for a superannuation product other than a MySuper product - means a fee charged for switching all or part of the member's investment from one investment option within the superannuation product to another investment option within that product; or*'.

(c) Paragraph (c) of the definition of "switching fee" for a managed investment product only covers the less common instance of a managed investment product having multiple investment options. In most cases, however, a managed investment product will comprise a single investment strategy with the more traditional concept of a 'switch' therefore being a transfer of an investment amount from one managed investment product to another managed investment product. In this case, a 'switch' is effectively a redemption from one managed investment scheme and an application into another managed investment scheme, which is often a feature when a series of funds forms part of a 'product' offering in a multi-fund PDS. Subject to the minor amendment underlined within the table in paragraph 68 (which is proposed to provide additional clarity), the current definition caters more to the exception rather than the norm. Is it ASIC's intention to avoid potential double counting where a switch from one managed investment product to another managed investment product could entail a withdrawal or exit fee for the managed investment product being switched from and/or an establishment or contribution fee for the managed investment product being switched into?

68. In the context of MySuper, whether or not a definition of "switching fee" is relevant (and the precise terms of the definition) should depend on how MySuper is structured (whether as a stand-alone MySuper product, or as a discreet MySuper investment option within a combined MySuper/Choice super product). As noted in paragraph 67(c) above, the definition of switching fee for managed investment products only has relevance for the less common case of investment options being offered within a single managed investment scheme (the more common case being a "switch" between separate managed investment schemes which in reality is a redemption from one scheme and an application into another scheme). The table below summarises when we consider a "switching fee" definition is necessary or not necessary (for both superannuation and managed investments), and for ASIC's consideration possible definitions of "switching fee" (where applicable):

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Superannuation fund – switching fee definition variations			
Product	**MySuper only product**	**Non-MySuper (i.e. choice super) only product**	**Combined MySuper/Choice super product**
Investment option/s	*MySuper investment option only*	*Multiple choice investment options*	*- MySuper investment option* *- Other (i.e. choice) investment options*
Switching fee definitions – super fund	***Not applicable*** - there are no other investment options in a stand-alone MySuper product.	"for a superannuation product other than a MySuper product - means a fee charged for switching all or part of the member's investment from one investment option within the superannuation product to another investment option within that product"	"where a MySuper product is offered as a MySuper investment option within a superannuation product, switching fee means: - a fee to recover the cost of switching all or part of the member's interest from the MySuper investment option to another investment option within that product; or - a fee charged for switching all or part of the member's interest to the MySuper investment option from another investment option within that product"
Managed investment products – switching fee variations			
Investment option/s	*Managed investment schemes with single investment strategy*		*Managed investment schemes with multiple investment options*
Switching fee definitions – managed investment products	***Not applicable*** - although 'switching' is often a 'product' feature available when a series of managed investment schemes is offered by the issuer in a multi-fund PDS, a 'switch' in this context is effectively a redemption from one managed investment scheme and an application into another managed investment scheme. If it is ASIC's intention to avoid potential double counting (i.e. where a switch in this context could entail a withdrawal or exit fee for the managed investment scheme being switched from and/or an establishment or contribution fee for the managed investment scheme being switched into), then the switching fee definition should apply only to managed investment schemes with multiple investment options.		"means an amount paid or payable when a product holder transfers all or part of the product holder's interest in the managed investment product from one investment option to another within that product"

69. The alternative 'switching fee' definition proposed in the Class Order should therefore be amended to reflect the sub-category definitions we suggest in paragraph 68 above.

ASIC Question B1Q4: Are there any unanticipated consequences from these amendments?

70. Below are some potential unintended consequences which have been identified in the limited time available to consider the Class Order (which involves complex concepts and drafting). We also refer ASIC to our other comments throughout this submission which may generate

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unintended consequences (and a lack of understanding or consistency as to the meaning and application of certain parts of the Class Order).

(a) **Interposed vehicle definition**: The definition of an "interposed vehicle" is complex and in the case of sub-paragraph (c)(ii) the operation is unclear and may be open to interpretation.

(b) **Section 29QC implications**: APRA superannuation reporting form SRF 702.0 requires the reporting of indirect costs on a *look through basis* where *look through basis* means the reporting of information about the underlying investment in an investment vehicle for the purposes of identifying fees and costs that relate to connected service providers that are not directly engaged by the RSE licensee, but are engaged by other service providers and involves looking through cascading entities to the first non-connected entity. This definition is at odds with the definition of indirect costs in the Class Order which requires a trustee to look through *beyond* the first non-connected entity. This may cause potential issues from 1 July 2015 in relation to section 29QC of the SIS Act that requires trustees to disclose the same or equivalent information in a consistent way to the information reported to APRA.

71. Another unintended consequence of the amendments in the Class Order is that "return" could be interpreted in a way that means that there is little or inconsistent disclosure of indirect costs.

72. ***Periodic statements***. In addition to our comments elsewhere in relation to periodic statements, if ASIC proceeds with a Class Order, then the Class Order should be amended to take the opportunity to correct the technical drafting problems of Part 3 of Schedule 10 *Corporations Regulations* which govern fee disclosure in superannuation *periodic statements*.

73. As it stands, only indirect costs are required to be disclosed in *periodic statements* which presumes that all other fees are shown elsewhere in the statement. This is not the case because investment and administration fees may not be deducted directly from member accounts (and therefore shown as a transaction) thus leading to a potential gap in disclosure (or inconsistency in terminology and disclosure in relation to indirect costs as used in PDSs versus as used in periodic statements) if changes are not made to the Class Order in respect of periodic statements. To address this, the changes proposed in paragraphs 53 and 54 above should be included in the Class Order if the Class Order proceeds.

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Interposed vehicles in managed investment schemes

ASIC Question B2Q1: Do you agree with the provision that a responsible entity may reasonably estimate indirect costs when these costs are not known? If not, how do you propose that indirect costs of an investment be disclosed when these costs are not known?

74. We do not agree with a provision that a responsible entity may reasonably estimate indirect costs when the responsible entity does not know those costs. Rather if not known, then they should not require disclosure (of course we expect responsible entities to exercise due process and responsible entities must not act such as to be wilfully blind to fees they would otherwise know).

75. ASIC's changes to the fee regime in relation to managed investments are particularly significant. The June 2013 *Superannuation Legislation (MySuper Measures) Amendment Regulations 2013* did not amend the concept of management costs for managed investment products. The ASIC Class Order replaces this concept with an indirect cost concept as used in superannuation. Such changes should be the subject of a holistic Treasury led consultation on fee disclosure.

76. Subject to our comments above, it would be helpful if the definition of an indirect cost of a MySuper product or an investment option offered by a superannuation entity or an investment option offered by a managed investment product were consistent.

77. The manner of consistency (between the superannuation and managed investments fee disclosure regimes) would require further consultation and a roundtable which we seek (see Section 5 of this submission) if ASIC proceeds with the Class Order. Consistency between superannuation and managed investments would enable a superannuation entity that offers a managed investment scheme directly to members to adopt the ICR of the managed investment scheme knowing that the ICR of the managed investment scheme will capture all of the required indirect costs that have been included in management costs. For example, transaction costs are not included in management costs for managed investments and this should also be applied to superannuation.

78. Similar to the points raised in our response to question B1Q1, it is not clear how a responsible entity could be expected to reasonably estimate an indirect cost if it does not have the information on which to base such an estimate even if it reasonably ought to know that such indirect costs exist and has taken the reasonable steps to ascertain such costs.

ASIC Question B2Q2: Are there any unanticipated consequences from these amendments?

79. The definition of an 'interposed vehicle' is complex and in the case of sub-paragraph (c)(ii) the purpose is not clear and may be misinterpreted. The rest of our submission sets out other potential unanticipated difficulties or consequences which, in the limited time available to consider the matter, we have identified.

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Defined fees and switching fees

ASIC Question B3Q1: Does the definition of switching fee result in instances of double counting of a fee where a switch from one product to another within a superannuation entity may be captured by another fee?

80. The revised definition of switching fee can now be applied consistently across MySuper products and choice products in a superannuation entity and hence there should be no instances of double counting.

Consumer advisory warning

ASIC Question B4Q1: Do the amended consumer advisory warnings more accurately reflect the appropriate terminology for superannuation and managed investment products, and reduce confusion for members?

81. The inclusion of a consumer advisory warning ("**CAW**") for managed investment products distinct from superannuation products is helpful, however there remain issues with references to "your employer" for personal superannuation products and with references to fee negotiations for products where it is not possible to negotiate all or some of the fees – see our response to B4Q2 below.

82. In FSC's submission dated 26 August 2014 to ASIC in relation to an earlier draft of the Class Order, FSC provided ASIC with an appropriate solution that overcomes the need for separate CAW disclosures for superannuation and managed investment products. The current proposals contain the following flaws (which we acknowledge are contained in the regulations):

    (a) The word 'account' in the 2nd paragraph of the CAW is not correct for investors investing indirectly in a managed investment product (e.g. via an IDPS). They will have an investment, but not an account (i.e. the account in the fund's registry will be held by the IDPS operator investing on behalf of its indirect investors) in the fund. Therefore, the more generic term 'investment' should be used, which is also suitable in a superannuation product (including MySuper) context.

    (b) The fourth paragraph of the CAW is potentially misleading if no fees are actually negotiable. Issuers should be able to customise this paragraph to include only the types of fees and costs that are in fact negotiable (and by whom). This should extend to not including this paragraph at all if no fees are actually negotiable.

83. In the Class Order, 'www.moneysmart.com.au' in the last paragraph is enclosed within ((double brackets)) in the proposed managed investment product version. Is this intended?

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ASIC Question B4Q2: Are there any products which would benefit from amended terminology (e.g. the removal of references to 'employer')?

84. For personal superannuation products the reference to "Your employer" should be replaced with "You" to the extent that fees are able to be negotiated.

85. Where either a superannuation or managed investment product does not offer the ability to negotiate fees then the paragraph referring to possible fee negotiations should be able to be removed from the relevant PDS.

86. For a superannuation product where it is possible to negotiate to pay lower fees other than administration fees, such as investment fees, then these fees should be included in the relevant paragraph in addition to or replacing the reference to administration fees as applicable.

87. For a managed investment product where it is possible to negotiate fee types other than just contribution fees or management costs, or where it is only possible to negotiate one or other of contribution fees or management costs, then only the relevant fee types that can be negotiated should be included in the relevant paragraph.

Section 4 – A sample of costs of forcing the industry to roll PDS in 8 months (by June 2015)

88. The following high level cost data has been provided by a sample of FSC members if issuers are required to update PDSs for the Class Order by 1 July 2015:

(a) *FSC Member 1*

The potential cost incurred by FSC Member 1 to comply with the Class Order and implement the changes to disclosure (including sending notices to members) is approximately $2.3 million.

(b) *FSC Member 2*

For Member 2, a forced replacement by 1 July 2015 of all PDS and related documents that are potentially impacted by this Class Order would currently involve reissuing out-of-cycle long-form PDSs, supplementary PDSs, shorter PDSs and Incorporation by Reference material.

The incremental abnormal cost of Member 2 doing so is conservatively estimated to be at least $1.3 - $1.5 million, excluding printing. Printing of relevant documents would likely take this figure beyond $2 million, without taking into account destruction of stocks of existing documents that would be rendered obsolete. Regardless of whether this cost is partly or wholly borne by Member 2 and/or on charged to members/investors via abnormal expense recoveries, this is an extravagant

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cost to incur to remedy disclosure documents for issues arising solely from unclear regulations.

(c) *FSC Member 3*

A high level estimate of the cost to roll PDSs for Member 3 would be in the region of $500,000 to $1.5 million depending on the complexity of the changes required, but perhaps $1 million would be a ballpark estimate.

(d) FSC Member 4

An out of schedule PDS roll of all Member 4's products across superannuation and managed investments would exceed $2.0 million.

(e) FSC Member 5

FSC Member 5 has estimated that the cost to roll PDSs by 1 July 2015 would be approximately $1.02 million. This covers basic design, printing and distribution and does not take into account consequential costs such as those related to excess stock (if any) which would become obsolete.

89. We think these costs clearly justify a reasonable transition such that the Class Order (if proceeded with) should only apply to superannuation PDSs *issued on or after 1 July 2015* and to managed investment PDSs *issued on or after 1 July 2016*. These timeframes are on the basis that the Class Order (if proceeded with) is finalised shortly.

90. For the record, FSC strongly argued in the targeted consultation of an earlier draft of the Class Order, that ASIC not compel PDS rolls by a certain date due to the costs of doing so. ASIC's response in paragraph 31 of ASIC's explanatory material *Proposed Class Order: Schedule 10 technical amendments* is that: "*While we accept [industry's] rationale for such an approach, our preference is for the 1 July 2015 transition date to be a "hard date", whereby all disclosure documents on issue at that time must comply with amendments outlined in the Class Order.*" ASIC note in paragraph 32 that it considers this provides sufficient time to implement any required changes. We urge ASIC to not disregard the millions of dollars of costs ASIC would thereby be imposing on industry (and potentially, consumers, to the extent such costs are passed on) if ASIC continues to insist with a 1 July 2015 hard start date.

91. It is our view ASIC has provided insufficient policy rationale for requiring industry to update PDSs by 1 July 2015 for changes made by an ASIC Class Order. FSC has only enquired of 5 FSC members of the cost implications of an ASIC imposed 1 July 2015 hard start date, and the aggregate costs of those 5 members of PDS rolls may be in the region of $8 million potentially.

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92. In ASIC's recent Statement of Intention (July 2014) in response to the Government's Statement of Expectation, ASIC states:

> **"Government's deregulation agenda**
>
> **Reducing red tape and compliance costs**
>
> ASIC is aware of the burden unnecessary red tape can impose on business and the potential impact of this on productivity. To address this, we continue to pursue initiatives to reduce red tape for individuals and businesses. We have already made significant recent progress in reducing the burden of red tape and contributed to the Government's annual $1 billion red tape reduction target.

93. We urge ASIC to reverse its decision to insist on a 1 July 2015 hard start date as ASIC's decision is unnecessarily imposing an avoidable cost on licensees (which may impact consumers to the extent such costs are passed on or included in expense recoveries). A reversal of ASIC's decision is in our view consistent with ASIC's Statement of Intention (July 2014). In summary, the transition of the Class Order should be (assuming the Class Order is finalised shortly) that it applies to superannuation PDSs issued on or after 1 July 2015 and managed investment PDSs issued on or after 1 July 2016. However trustees/responsible entities should be permitted to comply with the Class Order earlier if they can and choose to do so.

Section 5 - Suggested approach instead of proceeding with the current Class Order

94. We consider that a logical approach would be to await the outcome of the Financial System Inquiry prior to adopting further changes to the fee disclosure regime (other than addressing anomalies in the Consumer Advisory Warning and double counting in superannuation and in relation to switching fees).

95. If ASIC nonetheless proceeds with a Class Order, we would welcome an opportunity for a Roundtable involving Treasury, ASIC, FSC Members and other stakeholders to consult on fee disclosure matters prior to drafting the changes.

Please contact Stephen Judge on (02) 9299 3022 if you have any questions on our comments.

Yours sincerely

Stephen Judge
General Counsel

Appendix 1 – *ASIC Class Order, Legislative Instruments Act and the "reasonable estimate" requirement in proposed clause 101A*

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Appendix 1 – ASIC Class Order, Legislative Instruments Act and the "reasonable estimate" requirement in proposed clause 101A (where a trustee has no knowledge and cannot reasonably ought to have such knowledge). This Appendix summarises legal advice received by FSC.

1 Overview

This note considers the validity of proposed Class Order: Schedule 10 technical amendments (issued for public comment on 24 September 2014) (**Proposed Class Order**).

This note focusses on the proposed clause 101A(1) (as set out in the Proposed Class Order) to be inserted in Schedule 10 of the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**).

2 Summary

The proposed clause 101A(1) may be beyond power in its current form and accordingly, may be 'read down' to exclude references to 'may reasonably estimate' for the reasons canvassed below.

3 Applicable corporations law

The Proposed Class Order seeks to amend Schedule 10 of the Corporations Regulations by inserting a new clause 101A.

Schedule 10 of the Corporations Regulations is made under Division 4C of the Corporations Regulations and in particular, for present purposes, regulation 7.9.16L. Regulation 7.9.16L is made under section 1013D(4) (viz regulation 7.9.16L(1)) of the Act, which authorises the making of regulations which:

(a) provide that a provision of section 1013D(1) does not apply in a particular situation; or

(b) provide that particular information is not required by a provision of section 1013D(1), either in a particular situation or generally; or

(c) provide a more detailed statement of the information that is required by a provision of section 1013D(1), either in a particular situation or generally.

Regulation 7.9.16K provides that Division 4C of the Corporations Regulations applies in relation to product disclosure statements and periodic statements of certain superannuation products.

Accordingly, regulation 7.9.16L (contained in Division 4C) is applicable to the superannuation products contemplated by regulation 7.9.16K.

Regulation 7.9.16L provides that:

> **More detailed information about fees and costs**
>
> For paragraph 1013D(4)(c) of the [Corporations] Act, a Product Disclosure Statement must include the details of fees and costs set out in Part 2 of Schedule 10.

Section 1013D of the *Corporations Act 2001* (Cth) (**Corporations Act**) outlines the main content requirements for product disclosure statements. Section 1013D(1) requires information about the cost of a product to be included in a product disclosure statement which can include indirect costs.

However, section 1013C(2) of the Corporations Act provides that the content requirements outlined in section 1013D only need to be included in a product disclosure statement to the extent to which the information is '*actually known*' by the responsible person (emphasis added).

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None of the limbs of the regulation in section 1013D(4) would enable the knowledge criterion in section 1013C(2) to be amended.

4 Power to make the Proposed Class Order

The Proposed Class Order is made under section 1020F(1) of the Corporations Act. Under this provision, ASIC may:

(a) exempt a financial product or a class of financial products from all or specified provisions of Part 7.9;

(b) exempt a person or class of persons from all or specified provisions of Part 7.9; or

(c) declare that Part 7.9 applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

Such Proposed Class Order takes the form of a legislative instrument.

5 Legislative Instruments Act 2003

Section 13(1)(c) of the *Legislative Instruments Act 2003* (Cth) (**Legislative Instruments Act**) provides that where 'enabling legislation confers on a rule-maker the power to make a legislative instrument, then…any legislative instrument so made is to be read and construed subject to the enabling legislation as in force from time to time, and so as not to exceed the power of the rule-maker.'

Further, section 13(2) of the Legislative Instruments Act states that if 'any legislative instrument would…be construed as being in excess of the rule-maker's power, it is to be taken to be a valid instrument to the extent to which it is not in excess of that power.'

In *Comcare v Broadhurst* [2011] FCAFC 39, the Full Court of the Federal Court of Australia stated that section 13(1)(c) of the Legislative Instruments Act operates to inform that manner in which a mistaken assumption of power (in making a legislative instrument) is to be read and construed. In that case, the Court 'read down' the relevant instrument by striking out the elements that were beyond the power of the rule-maker.

Accordingly, the effect of section 13(1)(c) of the Legislative Instruments Act is that a legislative instrument will be 'read down' to the extent that it exceeds power to make it consistent with its enabling legislation.

The Corporations Act is the enabling legislation of the Proposed Class Order.

Clause 101A(1) of the Proposed Class Order operates to require a product disclosure statement to include information about the indirect cost of a MySuper product or investment option that a trustee or responsible entity does not know nor reasonably ought to know (namely a reasonable estimate).

…

Section 1013C(2) of the Corporations Act operates to limit information in the product disclosure statement to information actually known.

For this reason, clause 101A(1) is beyond the power of the rule-maker and may be 'read down' to the extent it requires a reasonable estimate of a matter (costs/expenses) for which the trustee has no knowledge and nor ought reasonably have knowledge.

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