3 March 2015

Mr Maan Beydoun
Senior Specialist
Investment Managers and Superannuation
Australian Securities and Investments Commission
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Dear Maan,

AVCAL submission on Draft RG 97: Disclosing fees and costs in PDSs and periodic statements

The Australian Private Equity and Venture Capital Association (AVCAL) appreciates ASIC's invitation to comment on the proposed revisions to Regulatory Guide 97 (RG 97), as set out in the Draft RG 97 dated December 2014.

AVCAL represents the venture capital (VC) and private equity (PE) industry in Australia, which has a combined total of over $24 billion in funds under management for domestic and offshore investors. Australian PE and VC firms invest in businesses on behalf of their fund investors, also known as limited partners (LPs). Superannuation and managed investment product issuers form a critical part of the LP base, and are also members of AVCAL.

As the superannuation sector continues to grow into a multi-trillion dollar industry, the needs and interests of superannuants, trustees, investment managers and other key stakeholders remain vitally important to ensure that that growth remains viable and sustainable. This includes the need for a fair and transparent system of fee and cost disclosure.

Overall, the ASIC report is an important step in addressing the issue of fee and cost disclosure for investors, and AVCAL welcomes the pursuit of ensuring clarity and consistency of disclosure across the superannuation and managed investment sectors.

In AVCAL's view, any rules and guidelines related to fee and cost disclosure should offer the right level of transparency for end-users of the information. Some of the key principles that we believe would improve the usefulness of fee and cost disclosures are summarised below:

- Consistent treatment of investments in unlisted entities vs listed entities
- Clear guidance on fee and cost disclosure when investing in unlisted trusts
- Further practical guidance on estimation of costs and fees
- Clear definition of costs and fees

1. Consistent treatment of investments in unlisted entities vs listed entities

The guidelines should be fair and impartial in aligning disclosure requirements between listed and unlisted entities. Both types of entities will often invest in and control similar underlying businesses as part of their operations. The treatment of costs related to managing those businesses should therefore not differ between the listed and unlisted entities that control them.

Example 8 in the draft RG97 says, for example, that costs associated with listed REITS investments do not need to be disclosed because they are listed on an exchange. This indicates that costs associated with unlisted REITS would need to be disclosed as indirect costs.

Furthermore, unlisted PE fund-of-funds disclose the fees and costs associated with their PE fund investments, but a listed investment company does not have a similar look-through requirement.

Similarly, fees reported by PE funds are often no different to the running costs of many listed entities. For example, PE fund managers disclose all relevant fees and costs that reduce the return to investors, such as directors' fees (which is included in the indirect cost ratio). However, listed entities (e.g. listed investment companies) would not be required to disclose the indirect costs of managing the businesses and companies that they control even when these have exactly the same effect of reducing the return to investors.

While this is current market practice, it reflects a stark inconsistency in the principles underlying the indirect cost metric, as there will exist very similar costs in listed and unlisted investments in both property and PE where some costs associated with unlisted investments are required to be included in disclosed cost metrics whilst identical costs embedded in listed investments are not.

This creates an unequal playing field as unlisted investments are penalised on a fee disclosure basis. The results in an inconsistent disclosure regime whereby fees for listed entities are underreported, even though their commercial practices may not significantly differ from that of unlisted entities.

Importantly, this inconsistency also raises investor protection issues as it compromises the comparability of fee disclosures related to listed and unlisted investments.

There is an urgent need for this to be addressed, as fee disclosures play an important role in informing portfolio allocations and retail client decisions.

AVCAL's recommendation is that all fee and cost disclosures should be consistent and reasonable across both listed and unlisted investments, in order to safeguard the integrity and comparability of these indirect cost ratios for users who rely on them for decision-making purposes.

2. Clear guidance on fee and cost disclosure when investing in unlisted trusts

AVCAL recommends more detailed guidance and further clarification on the factors ASIC considers in determining the circumstances under which underlying fees in unlisted vehicles, such as fund-of-funds or PE funds, should be disclosed by superannuation funds as indirect costs.

Example 6 in the draft RG 97 indicates if members are informed that the super fund invested its Infrastructure allocation into (say) an Infrastructure Trust then the super fund will not need to disclose any underlying fees or indirect costs.

AVCAL recommends further clarification on whether this means that fees and costs related to investments made through associated entity only have to be disclosed at the associated entity level, and not to the underlying investments/funds' level.

Further clarification that this principle applies to all asset classes (as opposed to just infrastructure) would be beneficial as well.

3. Further practical guidance on estimation of costs and fees

Estimation of fees incurred based on past performance can be a difficult exercise for trustees and investment managers. Forward-looking estimates based on future performance are even harder to predict with any certainty, and a danger arises when these estimates are provided to investors, as they may materially understate or overstate the actual fees that will be incurred in the future.

In order to properly disclose the effect of performance fees on investments or superannuation savings, one suggested method would be to disclose the conditions under which a performance fee would be incurred. Disclosing the conditions, rather than the quantum, of when a fee is incurred is a better and more practicable disclosure principle that does not result in possible misleading fee disclosure.

Likewise, reporting performance fees on a realised rather than forward-looking basis would increase the overall accuracy and data quality of fee and cost disclosure.

In relation to estimating direct costs, the draft guidance suggests that one has to make a reasonable estimate of costs based on "reasonable" assumptions and in a well-documented manner. The requirement to estimate future indirect costs based on a set of assumptions is only likely to cause more confusion as different investors will use different assumptions to derive an indirect cost estimate.

This point is also relevant in the discussion about disclosure of performance fees, which are highly variable by nature (RG 97.55 and 97.56). In the absence of clearer guidance this will lead to a wide range of estimates being reported across the industry for similar investments. RSEs will be required to estimate costs which are variable and contingent on certain relative outcomes (e.g. an equities manager outperforming an index by a certain percentage, made even more complicated where the calculation of outperformance is based on a measurement period of more than one year) or on a multi-year look-forward basis (e.g. estimating the performance fee that may be payable on a PE fund in many years' time).

Clearer guidance e.g. providing examples of how a super fund can perform these estimates, and the timeframe over which future performance fees are estimated, would be useful. It is not clear whether the estimate of performance fees is only required in relation to the following year or whether it should be a multi-year calculation - particularly important where performance fees are calculated on rolling multi-year periods (equities) or in a "back-ended" closed end fund structure. One suggestion might be for these estimates to be based on an average over a reasonable number of historical years, e.g. 5 years, which would help reflect at least a medium term estimate of future performance and partially smoothen year-on-year volatility in performances and costs.

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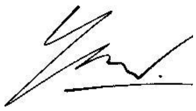
If you would like to discuss any aspect of this submission, please do not hesitate to contact me or Dr Kar Mei Tang on (02) 8243 7000.

Yours sincerely,



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