

CORPORATE SUPER ASSOCIATION

ABN 97 799 893 065

PO Box 508
Collins Street West
Melbourne VIC 8007
Tel: 03 8319 4075
Email: corpsuper@netspace.net.au
Website: www.corsuper.com.au

26 February 2015

Mr Maan Beydoun
Senior Specialist
Investment Managers and Superannuation
Australian Securities and Investments Commission
Level 5, 100 Market St
Sydney NSW 2000

Dear Mr Beydoun

REGULATORY GUIDE RG 97: AMENDED DRAFT, DECEMBER 2014 COMMENTS FROM THE CORPORATE SUPER ASSOCIATION

BACKGROUND

Established in 1997, the Corporate Super Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors.

The Association represents a total of 25 funds controlling \$65 billion in member funds, held in a total of 695,396 individual accounts. In general, these funds are sponsored by corporate employers, with membership restricted to employees from the same holding company group, but we also include in our membership several multi-employer funds with similar employer involvement and focus.

We appreciate ASIC's efforts to provide updated guidance on fee and cost disclosure. We refer to discussions in round table forum on 11 February 2015 and confirm the following areas of difficulty, relating to indirect costs.

IDENTIFICATION OF AMOUNTS THAT ARE INDIRECT COSTS

It would be helpful to provide a comprehensive list of possible types of indirect costs.

Indirect costs and interposed vehicles

Preferred approach

We wish first to state our views about the appropriateness of requiring disclosure of indirect costs through layers of non-associated (non-connected) investment vehicles.

CORPORATE SUPER ASSOCIATION

The definition of *indirect cost* in the Corporations Regulations, Schedule 10, clause 101A now includes amounts that directly or indirectly reduce the income of or property attributable to an interposed vehicle in or through which the property attributable to the product or option is invested. Such amounts are included *where the trustee of the entity or responsible entity knows, or reasonably ought to know or, where this is not the case, may reasonably estimate, the amounts involved.*

Our trustees are very willing to support disclosure of costs, particularly material costs which are disguised within layered structures. Nevertheless, we consider that the problems of knowledge or reasonable estimation of costs within entities unconnected with the trustee and with which the trustee has no direct contractual relationship or influence can pose considerable difficulties and can involve the trustees in expense which is difficult to justify in terms of benefits to members.

In APRA's Reporting Standard SRS 702.0, clarified also at APRA FAQs 66 and 93, look-through reporting does not apply to layers of non-connected investment vehicles below the first non-connected vehicle, although FAQ 93 has now been modified to state that:

RSE licensees are also *encouraged* to make all reasonable efforts to obtain information about their investments beyond the first non-connected entity, as APRA is of the view that obtaining this information reflects sound investment governance. If an RSE licensee already receives this level of information in relation to its investments, it should make all reasonable efforts to continue to receive this in future. Where this level of information is available to an RSE licensee, it should be reported to APRA.

This approach is pragmatic and recognises the difficulty of locating information and estimating costs which are often outside the control and access of the trustee.

The process of uncovering the full information can be very expensive and it is questionable whether gaining it carries benefits commensurate with the costs.

It would seem that consistency with the above approach would permit the reporting of fees under Schedule 10 to be limited to those costs incurred in relation to the fund or manager who is sourcing the specialist investments for the superannuation fund, whilst making reasonable efforts to secure additional information about underlying fees and reporting these and other information which has been gained under due diligence.

We understand that a major purpose of reporting of indirect costs is the disclosure of fees paid to associated parties which have not been transparent in the past. Following the method of calculation used by APRA for these purposes, involving detailed reporting up to the first non-associated layer seems to us appropriate to achieve the aims.

The Association recognises, however, that ASIC's approach in CO 14/1252 and RG 97 does not draw the line at the first non-associated entity in the chain. Instead, guidance is directed to providing information to the best of the trustee's ability, regardless of the distance of the relationship between trustee and ultimate investment.

The comments that follow recognise ASIC's approach.

CORPORATE SUPER ASSOCIATION

Further Comments on ASIC's Current Approach to Disclosure of Indirect Costs

Estimating indirect costs

We appreciate the guidance at RG 97.34 on estimating indirect costs and concur with the recommended approach to documentation at RG 97.36.

However, further clear guidance is needed on what is a reasonable estimate of indirect costs and also on what is not reasonable.

We have the following additional comments relating to the estimating of indirect costs.

Funds of funds

There can be situations where exposure to private equity or other specific exposure is obtained by investing in a fund which then uses a palette of funds to gain exposure in the desired areas ("fund of funds"). Whilst the trustee will have performed appropriate due diligence in selecting the fund of funds and reviewing the overall estimated costs, it may be a complicated process at a point in time to obtain immediately accurate up to date information on the second and further layers of costs.

In most cases the fund of funds vehicle does not invest immediately, and the investments adopted may be chosen from a range, as opportunities present. Typically, the investments are then undertaken, progressively, in tranches. Indirect costs can only reasonably be estimated when underlying products are chosen and funded by the FOF manager.

The "reasonable estimates" approach in this situation may involve the gathering of data at the due diligence stage, and then review as data emerges on a regular basis.

Performance fees

We have difficulties with the position taken in RG 97.55 and 56 that it is unreasonable to estimate performance fees on the basis of past performance. In some cases, this is the only reasonable approach, subject to adjustment for available data.

The criteria and method for determining performance fees will have been agreed at point of entry into an investment. However, the actual amount from year to year will only be determined once performance is known. An additional difficulty arises in private equity style investments, where a performance fee is typically only payable upon the sale of the investment and is netted off the capital returned. Assessing such future payment timing and quantum is very difficult. For the latter, at least, reporting the last 12 months fees paid is the only practical approach. Some difficulties arise in relation to quoting an average over a longer period.

The consumer is alerted to the uncertainties by the requirement for the inclusion under the heading, 'Additional explanation of fees and costs' a statement about how performance fees affect administration fees and investment fees for a superannuation product, or management costs for a managed investment product.

Costs Relating to OTC Derivatives

We note the comments (RG 97.46 to RG 97.51) on buy-sell spread for OTC derivatives for superannuation funds and for managed funds.

CORPORATE SUPER ASSOCIATION

We are concerned in particular by the contrast in treatment of buy/sell spread for OTC derivatives used for hedging purposes by managed funds, and the resulting lack of comparability between a superannuation fund and a managed fund making the same investment in derivatives. The difference in treatment of managed funds becomes particularly involved where a fund invests in a managed fund. This is especially relevant for hedge contracts, undertaken to reduce risk exposure, such as currency hedges, and futures contracts undertaken to position a portfolio. These fall into a different category from those synthetics used to replicate a non-synthetic investment, such as a swap that replaces a cash deposit.

If it is considered that indirect costs for a superannuation fund must include the buy-sell spread on OTC derivatives, and this situation results from a legislative anomaly between the treatment of buy-sell spreads for managed funds and superannuation funds, we believe that any anomaly needs to be acknowledged and then addressed.

Clarity is needed as to what is and is not a transaction cost. In our view, a transaction cost is incurred in relation to the purchase (sale) of an underlying asset, and is incurred by direct and indirect investors alike: in fact, to include such a cost within indirect cost in an interposed vehicle carries the risk of double counting. We do not believe that such costs sit well within indirect costs.

Listed and unlisted vehicles

We refer to the discussion in RG 97.33. It appears to us that the discussion, and the examples provided, may give the impression that listed vehicles are more likely to be target investments in themselves. It could be made clearer that the listed or unlisted status does not affect whether the vehicle holds target investments directly (and that rather, in the case of unlisted vehicles, whether target investments are held directly or accessed through interposed entities needs to be determined from the fund's disclosure documents).

Clarification of this point is needed, given that the examples could be read as indicating that a listed trust is not an interposed vehicle but an unlisted trust is an interposed vehicle; if so it would create an advantage that may influence investment decisions in an inappropriate way.

Example 5 causes some confusion because of a misprint which refers to the investments made by the company as securities or financial products. We believe there is a need for more examples at paragraph 97.33 of interposed vehicle situations, especially for layered arrangements, with explanations as to the conclusions.

Yours sincerely



Mark N Cerché

Chairman

Corporate Superannuation Association