

REVIEW OF  
REGULATORY GUIDE 97

# Disclosing fees and costs in PDSs and periodic statements

SUBMISSION

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## ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members. Please direct questions and comments to:

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# RG 97 DISCLOSING FEES AND COSTS IN PDSS AND PERIODIC STATEMENTS

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## Introduction

ASIC's report 398 notes that "consistent and accurate fee and cost disclosure is an important aspect of the disclosure framework".<sup>1</sup> The report found that the industry had adopted various interpretations of the disclosure requirements found in Schedule 10 to the *Corporations Regulations 2001* (the Regulations).

ISA agrees, without consistency there is no transparency or comparability. Improved and adequate disclosure was a central pillar of the Stronger Super reforms. ISA supports the recent disclosure changes that will facilitate greater confidence in the superannuation industry.

ASIC class order 14/1252 followed a review of industry fee and cost disclosure practices and revised a number of definitions, including direct cost, management cost, switching fee and interposed vehicle.

The updating of regulatory guide 97 to reflect the Stronger Super regulatory reforms, including class order 14/1252 and a greater focus of disclosure and comparability is welcomed. The use of examples to provide guidance is welcomed and will aid consistency of approach by the industry.

ASIC and APRA are currently consulting with industry regarding the implementation of s29QC of the SISA. These matters are related and in the event that this process results in regulatory guidance and or relevant class orders, regulatory guidance 97 may require revision.

ISA is generally supportive of the proposed regulatory guide.

## Investments through interposed vehicles

There can not be adequate disclosure without a requirement to properly estimate the level of indirect costs (e.g., outsourced funds management) to consumers. Appropriate levels of transparency are required to ensure the cost associated with investing via interposed vehicles is disclosed. We concur with paragraph 97.20 that costs associated with investing through interposed vehicles "...are not costs that an investor would necessarily incur if they invested directly in the underlying investment assets."

**B1Q1 Do you consider the guidance provided on the interposed vehicles to be sufficient to properly explain when a body, trust, partnership or other structure would be an interposed vehicle?**

It would be helpful if examples 3 and 4 included an explanation why the vehicles are considered interposed. We suggest that example 5 needs rewriting to improve clarity.

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<sup>1</sup> ASIC Report 398 July 2014 paragraph 9

**B1Q2 Are there additional examples that you consider should be included in RG 97 which would assist in clarifying or explaining the interposed vehicle definition and its application?**

A diagrammatic approach to certain examples should be considered.

**B1Q3 The application of interposed vehicles and indirect cost varies between superannuation and managed investment products. Do you consider the proposed RG sufficiently explains these differences?**

Yes.

## Requirement to reasonably estimate indirect costs

The proper and timely estimation of indirect costs is essential to ensure product issuers provide costs information to consumers that are not potentially misleading. It is suggested that trustees may be in breach of their duties to superannuation fund members and their licence conditions where they knowingly or by reckless omission do not update fee or costs information that could have a material impact on fund members. The provision of reasonable estimates of indirect costs and their updating is essential to avoid fee-gaming and to allow engaged consumers to adequately compare fees and costs.

We believe the guidance should make clear that, to satisfy the ‘reasonableness’ standard, the issuer’s estimates must be reasonable *and* the issuer’s efforts to obtain information from third parties to prepare the estimate is reasonable. Put another way, issuer’s should understand that their estimate cannot be reasonable if they have not undertaken a reasonable investigation. The current language “issuers may use a variety of sources of information and assumptions considered to be reasonable,” could be interpreted to permit issuers to conduct no investigation of its contractual providers, or to include clauses in its contracts with outsourced providers that require reporting of information from the provider to the issuer.

We also recommend that ASIC encourage issuers to have a board policy to ensure that the quality of estimates are reviewed, and that (i) material deviations are reported to ASIC, and (ii) approaches to disclosure are updated where disclosed estimates are found to deviate materially from the actual fees and costs. We also believe issuers should have an obligation to periodically audit their “supply chain” to ensure the fees and costs reported to the issuer by outsourced service providers are accurate.

**B1Q4 Do you consider the guidance provided on the requirement to reasonably estimate indirect costs would assist you in complying with this requirement?**

To aid consistency of approach it is suggested that further examples could be provided in this section of the guidance.

We suggest that paragraph 97.35 be amended to suggest that it would be reasonable for an issuer to update the disclosure regarding the estimate of indirect costs where the revised estimate is considered a better estimate and make a **material** difference of what will be paid in the future. We suggest that a material difference would be an expected variance of more than 5 per cent.

**B1Q5 Do you agree that it would be a matter of good practice for trustees and responsible entities to document their procedures for making reasonable estimates as a means of enhancing consistency?**

We concur with the guidance in paragraph 97.36 that states that “As a matter of good practice issuers should document their procedures for making reasonable estimates of costs – as well as the type of information and assumptions they may consider when making these estimates – as part of their obligations to have adequate compliance arrangements and risk management systems.”

To aid consistency the regulatory guide should indicate which assumptions are reasonable and at a high level, what internal procedures should be adopted to make a reasonable cost estimate.

We put forward that the guidance should at the very least suggest external audit sign-off on documentation. Common industry practices for the making of reasonable estimates would aid industry and consumers, consistent with Report 398, the guidance could suggest the adoption of common industry mechanisms would be beneficial.

Any procedures used by issuers to estimate costs should be readily available to any interested party, including consumers. Informed consumers are rightly interested in the trustee’s ability and efforts to reasonably estimate costs.

## Over the counter derivatives costs

**B1Q6 Do you consider the guidance and examples sufficient to understand the appropriate treatment of buy/sell spreads of OTC derivatives for superannuation and managed investment products?**

Yes. ASIC may wish to consider whether the guidance is adequate for other kinds of derivative cost models. For example, some OTC derivatives are essentially European options, and the cost may take the form of a premium (and the payout may be fixed; if it floats there may be a buy-sell spread or haircut between the value of the reference for the payout and the market value of the reference.)

We did not find persuasive the rationale expressed in the guidance for treating cost disclosures about OTC derivatives that an MIS issuer characterises as “hedged” differently than other OTC derivatives. We would recommend ASIC reconsider this because (i) it invites regulatory arbitrage and (ii) an investor in the MIS would still want to know if the MIS was using a derivatives provider who charged an unusually large spread for the hedge. Characterising a buy-sell spread as a “transaction cost” based on the purpose of the instrument strains the plain meaning of “transaction cost.”

**B1Q7 Is the guidance provided sufficient to apply the definition of buy/sell spread of OTC derivatives when used for hedging purposes by a responsible entity of a managed investment product?**

Yes. We concur with paragraph 97.51 that the costs cited form part of the indirect costs under cl 101A and are not excluded from management costs under cl 102(2).

## Inclusion of additional voluntary information

ISA is of the view that sufficient information should be readily available in an accessible manner to allow consumers to make an informed decision regarding any matter that may have a material impact on the performance of a superannuation fund, and to enable interested third parties to provide analysis about the fund and across funds. This includes fees and cost information that is up to date and includes payments to related parties.

We agree that unless there are unusual circumstances additional voluntary information should not be provided in the fees and costs template as this may impair the ready comparability of products by consumers.

ISA agrees with paragraph 97.66 that states that “Issuers are encouraged as a matter of good practice to include additional information to describe the break-up of fees and costs to show any amounts paid to related parties with an explanation of the basis of the payment.” ISA is aware that some sections of the industry have argued that the inclusion of paragraph 97.66 would add nothing to the consumer experience. We disagree and are firmly of the view that the inclusion of paragraph 97.66 would add to the ability of a consumer to make an informed decision regarding the issuer’s offering. It is suggested that the definition of related party found in s228 of the *Corporations Act 2001* would suffice.

More generally, financial services providers, including in the MIS and superannuation space, have become more horizontally and vertically integrated. This trend is unlikely to reverse. These arrangements have demonstrably sharpened agency risk and potential conflicts of interest between the institutions and consumers, and along the “value chain” within institutions. While disclosure should not be the only tool for combatting the risk of consumer harm arising from these structures, ASIC’s guidance has a role to play. We believe effective disclosure of the economic substance of related party arrangements within these integrated business models should be an important ongoing concern for ASIC in preparing and renewing its guidance.

### **B1Q8 Do you consider this guidance to be appropriate?**

We concur with the guidance in paragraph 97.66 that issuers should as a matter of good practice include additional information to describe the break-up of fees and costs and the amounts paid to related parties and the purpose of the payment. This should form part of the issuers’ conflicts of interest policy. We suggest that further practical guidance via example would assist consistency of disclosure.

## Performance fees

### **B1Q9 Do you consider this guidance to be appropriate?**

Generally yes.

### **B1Q10 Are there scenarios that you consider it would be appropriate to give further guidance on?**

ISA agrees with proposed paragraph 97.109. We believe that additional guidance is required to emphasise when an estimate of expected performance fees is or is not reasonable. Reference to past performance fees is required to be reasonable and in certain circumstances this reference would not be reasonable; say when there is a material change, including a fund's asset allocation. Examples of reasonableness of estimates would be helpful and aid consistency of treatment.

## Insurance disclosure

### **B1Q11 Do you consider this guidance to be appropriate?**

We believe the guidance regarding insurance disclosure can be improved. Insurance costs can have a dramatic impact on member retirement benefits. ISA believes that insurance disclosure is generally insufficient and should be the subject of greater prescription with an aim of facilitating comparability. ISA supports the proposed guidance that the costs detailed in paragraph 113 should be disclosed. In addition, we believe that default assumptions regarding age, occupational loading, etc. should be disclosed.

In addition to the disclosure of the level of adviser commission the components of the commission (up front and ongoing) should be disclosed.

### **B1Q12 Do you recommend any other guidance that should be included to further assist industry in this area?**

It is suggested that examples of appropriate insurance disclosure would be advantageous and would aid consistency and comparability.

## Disclosing fees and costs for a stapled security

### **B1Q13 Do you consider this guidance to be appropriate?**

Yes

### **B1Q14 Do you consider that it would be more appropriate for PDS prepared for stapled securities to be prepared on the basis of combining the fees and costs for the managed investment scheme and body corporate security components, in a similar manner as required for periodic statements for listed and quoted stapled securities under Class Order 13/1200? If so, do you consider it appropriate for ASIC to give effect to this requirement by way of a class order?**

ISA concurs that it is good practice when a joint disclosure document is used for a stapled security for all fees and costs information to be aggregated into a single presentation of fees and costs. The issuing of a class order would provide greater clarity.



**B1Q15 If PDS need to be prepared on the basis of combining the fees and costs for the management investment scheme interest and body corporate security components; do you consider it would still be useful and necessary to disclose the fees and costs on a separate basis as well?**

We are of the view that the separate costs should also be disclosed.

## Disclosing start-up and initial one-off fees or costs

**B1Q16 Do you consider this guidance to be appropriate?**

Yes

**B1Q17 What examples do you consider useful for responsible entities to include in the PDS for investors to understand start-up and other initial one-off fees?**

The proposed guidance is supported. In addition we suggest that it would be good practice for product issuers to appropriately emphasise the level of start-up or once off fees or costs and to who the fee is paid. We do not suggest further examples.

## Conclusion

ISA is generally supportive of the guidance provided and believes it will enhance reporting consistency and transparency. We suggest minor amendments and further examples which we believe will provide greater clarity. The full disclosure of fees and costs must include relevant up to date information that is concise and readily understood by consumers and other interested parties. All material changes to expected fees and costs should be amended in relevant disclosure documentation as soon as practicable. ISA believes that it is good practice and consistent with the existing duties of trustees to report all fees and costs in an adequate and timely manner. This would include the costs of investing via interposed vehicles and details of related party costs.

ISA supports a facilitative approach to the adoption of the guidance.



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Consider a fund's PDS and your objectives, financial situation and needs, which are not accounted for in this information before making an investment decision.

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