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**Private and Confidential**

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Dear Maan

**Subject: Review of Regulatory Guide 97 (“RG 97”) – Disclosing fees and costs in PDSs and periodic statements**

We are pleased to provide this submission in response to ASIC’s paper *Review of Regulatory Guide 97 – Disclosing fees and costs in PDSs and periodic statements* (“the review paper”).

Towers Watson is a leading global professional services company that helps organisations improve performance through effective people, risk and financial management. With 15,000 associates around the world, we offer consulting, technology and solutions in the areas of benefits, talent management, rewards, and risk and capital management. In Australia, we provide consulting, actuarial and investment services to a broad range of defined benefit and accumulation superannuation funds including standalone corporate funds, industry funds, master trusts and master trust sub-funds, and a wholly owned subsidiary of ours acts as trustee to a number of corporate funds.

We support ASIC’s efforts to obtain consistency in the disclosure of investment fees and indirect costs in superannuation fund disclosure documents. We do, however, wish to raise several issues in relation to the proposed amendments to RG 97 and to ASIC Class Order CO 14/1252 (“CO 14/1252”).

**RG 97.147**

Many of our clients that are corporate funds or industry funds invest wholly or partly through investment structures such as unit trusts, PSTs, portfolios, listed companies or other structures managed by an investment management firm. Hence this issue is very important.

The fees for the investment management under these structures are typically deducted directly from those structures by the investment management firm. Hence the trustees of the funds using these investment structures do not charge members a fee for these investment arrangements. Rather, the investment returns the fund receives from these structures are net of the investment management firms’ fees, and hence the portion of the investment returns allocated to the accounts of the members of these funds in respect of these structures, through mechanisms such as unit pricing or credited rates, are net of the investment management firms’ fees.

Until now, it has often been a confusing issue for trustees using these vehicles as to whether such fees should be disclosed as “investment fees” or “indirect costs” (or previously “management costs”). If our interpretation of this revised RG 97 is correct, it is clear that such costs are now to be classified as indirect costs, as the structures described above fit the definition of interposed vehicles. Therefore, we understand that, based on the definition of interposed vehicle and the guidance in RG 97, such fees should universally now be disclosed as indirect costs. This clarity is welcome, as it should help trustees to adopt a consistent approach to such costs. However, it does mean that funds with different investment structures will disclose investment costs differently. In our view, this issue needs further consideration, which we address later in this submission.

This clarity in respect of the classification of fees and costs from these interposed vehicle investment structures is, however, potentially clouded by RG 97.147, which states in part:

*For example, where an issuer charges a percentage-based investment fee which is reflected as a reduction in the unit price or crediting rate, we would consider that fee to be charged to members and not included in the indirect costs.*

Some of our client funds invest only in interposed vehicles and hence do not charge percentage based investment fees themselves, they pass on the “fees” charged by (or perhaps better still, the “costs” incurred in respect of) the investment management firms they use through the unit pricing or crediting rates used to allocate investment returns to members’ accounts. It is therefore not clear to us whether RG 97.147 is relevant to such funds. We consider that the better view is that RG 97.147 does not apply to these funds’ arrangements and we expect that the fund trustees will adopt this approach. This means that all investment costs for such funds will be disclosed as indirect costs. We ask that ASIC clarify this position.

Others of our client funds invest in a mix of interposed vehicles and direct investments. A typical example of such a fund might be where the majority of investments are in interposed vehicles, but a small proportion of the assets are invested directly as no suitable vehicle could be found for a particular asset class. Based on RG 97, such a fund is likely to disclose the majority of its investment related costs as indirect costs, together with a very low amount as investment fees. While we consider that this is in accordance with the guidance in RG 97, we again ask that ASIC clarify this interpretation.

### **Performance fees and indirect costs**

As noted above, a number of our client funds invest solely in interposed vehicles. Therefore, fees charged by the managers of those vehicles will constitute, and will now be disclosed as, indirect costs. Where all of a fund’s investments are through interposed vehicles, the fund will be disclosing zero investment fees.

Some of those interposed vehicles charge performance fees to the funds that invest in them. However, RG 97.53 and RG 97.109 appear to refer to performance fees as being included in investment fees in all cases, based on the definition of “investment fees” in the Superannuation Industry (Supervision) Act 1993 (“the SIS Act”). It appears, therefore, that affected funds will be required to disclose estimated performance fees as investment fees but the other fees charged by the interposed vehicles as indirect costs. This would seem to be potentially confusing to members, and indeed inconsistent with the treatment of the primary investment fees charged by the managers of the interposed vehicles. As the primary investment fees of the interposed vehicles are classified as indirect costs as discussed above, it seems inconsistent to classify the (typically smaller) investment performance fees differently – as investment fees.

We therefore recommend that RG 97 be revised to include further guidance on the disclosure of estimated performance fees in the case where such fees are charged by interposed vehicles. If indeed our understanding is correct and funds which invest solely in interposed vehicles must disclose estimated performance fees as investment fees but the other fees charged by the interposed vehicles as indirect costs, we recommend this be stated explicitly in RG 97, ideally by way of example.

## Definitions of interposed vehicle and indirect costs

In the superannuation context, CO 14/1252 defines an interposed vehicle "...in relation to a MySuper product or an investment option offered within a superannuation product other than a MySuper product...". There are a number of superannuation funds which do not offer a MySuper product and some of them do not offer investment choice to members. However, they would invest solely in interposed vehicles if the definition of interposed vehicle applied to them. These funds may still need to consider how to disclose fees charged by those vehicles, for example, for the purpose of periodic statement disclosure. We therefore recommend that the definition of interposed vehicle be widened so that these funds are not excluded from the application of the definition.

Similarly, CO 14/1252 inserts a new clause 101A into Schedule 10 to the Corporations Regulations 2001 ("Schedule 10") defining indirect costs. In the superannuation context, the definition also excludes funds which do not offer a MySuper product and do not offer investment choice to members, but which would invest solely in interposed vehicles if the definition of interposed vehicle applied to them. We recommend that clause 101A be amended so as to not exclude these funds from the application of the definition.

By way of comparison, the new definition of switching fee in clause 209A of Schedule 10 refers to "superannuation products other than a MySuper product". This definition is sufficient to not exclude the type of funds referred to above.

## RG 97.150

RG 97.150 discusses ASIC's guidance that periodic statements should include disclosure of transfers from reserves. However, the discussion refers to regulation 7.9.37(1)(k) of the Corporations Regulations 2001, which is a requirement for fund information (i.e. annual report) disclosure rather than periodic statement disclosure. In our view, these fund or category level movements are more properly disclosed in annual reports than in periodic statements.

In addition, there appears to be text missing from the final sentence in RG 97.150, which breaks off in mid-sentence.

We recommend that RG 97.150 be reviewed in the context of these concerns.

## Disclosure in pure defined benefit categories of funds

Various sections of RG 97 refer to the application of the fee and cost requirements to pure defined benefit funds. A number of superannuation funds which are not pure defined benefit funds nevertheless continue to include categories of membership (which may or may not be formal sub-funds), usually closed to new members, which would be pure defined benefit funds if those categories were standalone funds. We strongly recommend that ASIC acknowledge the existence of these categories of membership in RG 97, for example by defining "pure defined benefit fund" as including such categories, so that trustees of such funds can explicitly rely on the applicable guidance in RG 97.

## Consumer advisory warning for superannuation products

Class Order 14/1252 replaced the consumer advisory warning for superannuation products in clause 221 of Schedule 10. Unfortunately it appears that an error has been made as the new warning for these products now refers to contribution fees and management costs, even though these terms are no longer used in relation to superannuation products. We recommend that the class order be corrected as a matter of urgency.

We also note the comment in RG 97.67 that additional voluntary information cannot be included in the consumer advisory warning. There also continues to be no exemption from the requirement to include the warning in product disclosure statements for defined benefit categories. However, ASIC's fee calculator is not appropriate for defined benefits, which means that trustees of such funds continue to need to include the warning and then warn members that the calculator to which they have just referred them is not applicable to them. We do not consider this to be effective disclosure and recommend that ASIC review this requirement.

**Treatment of amounts deducted to build up ORFR reserves**

RG 97.99 and RG 97.149 require that amounts set aside from investment returns to build up ORFR reserves should be included in indirect costs. We strongly disagree with this approach. APRA Prudential Standard SPS 114 Operational Risk Financial Requirement requires that each trustee must maintain adequate financial resources to address losses arising from operational risks that may affect the fund. APRA has stated, in section 9.1 of its discussion paper on prudential standards for superannuation dated 28 September 2011, that Stronger Super seeks to improve the safety of the superannuation system by introducing a risk-based financial requirement for operational risk. We consider that setting aside resources to benefit members in the event of operational risk losses is fundamentally different to the deduction of fees or costs. While we agree that such provisions should be disclosed to members, in our view they should be separately disclosed and not included in either fees or indirect costs.

**Consistency of disclosure of investment costs between funds**

Assuming our understanding of RG 97 in relation to interposed vehicles is correct, the outcome will be that funds that wholly or substantially invest via interposed vehicles will disclose the majority of their investment related costs as indirect costs, not investment fees. It is not clear to us that this is the outcome that the government and ASIC are seeking.

We consider that this situation could be confusing to members when they compare funds, as some funds will be disclosing all or the majority of their investment costs as investment fees, with a zero or small amount of such costs disclosed as indirect costs, while other funds will be in the reverse position, disclosing zero or a small investment fee and all or the majority of their investment costs as indirect costs.

This outcome would also appear to be inconsistent with the government's MySuper objectives. Paragraph 1.64 of the Explanatory Memorandum to the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill expressed the government's intention in relation to the headline fees applicable to MySuper products:

*...a trustee cannot charge above cost fees outside of the two main headline fees of a MySuper product — the investment fee and administration fee — and the advice fee which may be charged where the member seeks financial advice. These two main headline fees will be a key point of comparison between MySuper products, and therefore, by only allowing certain fees to be charged greater than cost recovery, this comparability will place downward pressure on the total fees that are charged to members in MySuper products.*

This indicates an expectation that the majority of investment costs would be disclosed as investment fees, which will not be the outcome for many funds following the guidance in RG 97 as drafted.

We would be pleased to discuss this submission or provide further information if required.

Yours sincerely



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