



AUSTRALIAN INSTITUTE of
SUPERANNUATION TRUSTEES

SHAPING PROFIT-TO-MEMBER SUPER

Consultation Paper 308: Review of RG 97 Disclosing fees and costs in PDSs and periodic statements

5 April 2019

AIST Submission to ASIC

AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$1.3 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary

In brief:

AIST welcomes CP 308 with its several steps towards greater transparency. However, CP 308 defers the biggest issues: Platform disclosure and aligning managed investment schemes with superannuation. Confusion will occur regarding technical matters if CP 308 is implemented as currently framed. Various member testing is underway without any consultation about the testing methodology. This project, along with many others, would have benefitted from being part of a substantive review of disclosure and reporting all aimed at improving members' best interests and system benchmarking.

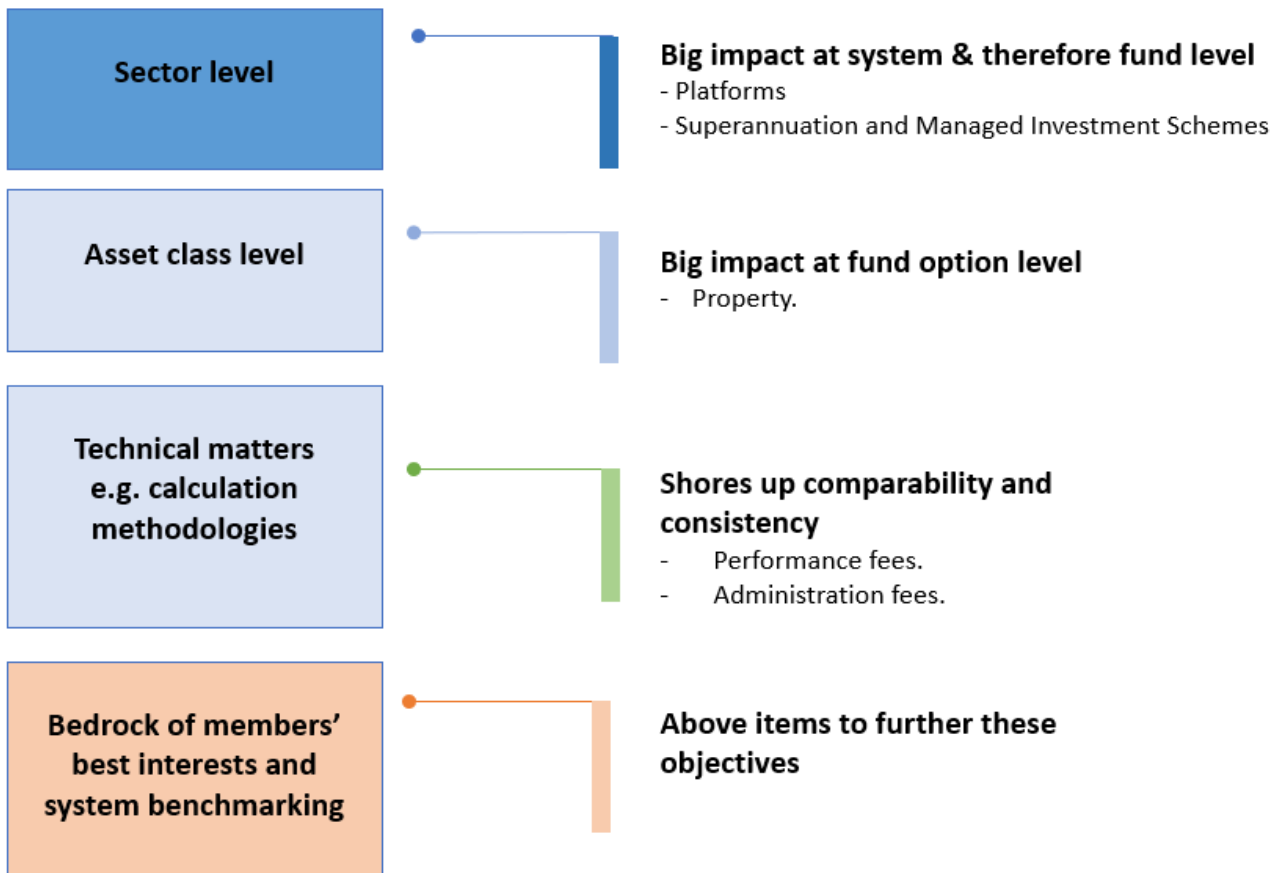
AIST welcomes the opportunity to comment on *Consultation Paper 308: Review of RG 97 Disclosing fees and costs in PDSs and periodic statements* (CP 308) which outlines ASIC's response to Darren McShane's report into fee and cost disclosure (REP 581).

We believe that CP 308 represents several steps forward given the proposals to provide greater alignment of direct property with listed property and the non-disclosure of implicit costs. However, we strongly advocate that CP 308 will not deliver against two key objectives:

1. Furthering members' best interests.
2. Enabling system benchmarking.

The reason is that the proposals contained in CP 308 would defer the key issues of platform exemptions and disclosure consistency between superannuation and Managed Investment Scheme (MIS). These issues are detrimental to members and have existed since 2014. AIST's advocacy has focussed on the need to fix these issues. ASIC's proposed deferral begs the question as to why they have not been dealt with – yet again. AIST is most concerned that the proposals outlined in CP 308 deal with details and not the key issues which would deliver the most value to members. Naturally, this means that CP 308 will not deliver a result which is in members' best interests. This is at a time when many matters investigated by the Royal Commission also have highlighted behaviour which was not in members' best interests.

In this submission, AIST examines whether the two key objectives have been met against a hierarchy of priorities for consistency and comparability.



Because we believe that CP 308 will not meet key objectives, this submission will focus on primary issues:

Sector level issues – AIST disagrees with ASIC’s proposal to defer significant issues

In relation to platform exemptions, we do not agree with ASIC’s proposed deferral and are uncertain whether platforms can comply with the Protecting Your Superannuation Package.

In relation to the issue of consistency between superannuation and the Managed Investment Scheme (MIS) requirements: We support efforts to build consistency through better labelling and guidance. However, these efforts may have limited effectiveness given the lack of guidance regarding fee and cost taxonomy or calculation methodologies.

Asset class issues – AIST welcomes ASIC’s proposal to improve

The issue of consistency between asset classes will benefit from the removal of property operating costs, borrowing costs and transactional costs from being required to be disclosed in PDS and periodic statements. However, we recommend that more work be undertaken.

Technical issues – AIST believes ASIC’s proposal would cause confusion

We note that the proposed handling of technical issues will cause confusion. Concerningly, the confusion is similar in style to issues we have witnessed throughout the RG 97 consultations. For example, how administration fees are handled begs the question as to the boundaries for inclusion or otherwise about costs. This is similar to the property operating costs issues. Other instances include:

- Performance fees – we note that an indication of these is considerably complex, however we are not yet happy with the proposed treatment.
- Implicit cost information – this is based on uncertain data and more work needs to be undertaken in respect of definitions prior to proceeding.
- Reserving – we believe that the current treatment is likely to lead to double counting.

We have raised several other matters at the end of the submission.

AIST believes that the various transparency projects currently in place would have been better conceived had there been a holistic approach to transparency. If one steps back and asks what is needed to ensure that members get the best value, it is difficult to conceive a fee and cost review without also conducting a review of risk, performance calculation, and what data is needed to benchmark system performance. We note that better data analysis, such as that produced by fee and cost disclosure, may have provided early detection and indeed prevention of some of the issues that were raised during the Royal Commission.

Introduction

AIST wishes to thank ASIC for seeking feedback on Consultation Paper 308 (CP 308), which contains ASIC's response to the recommendations made by Darren McShane in his report on fee and cost disclosure (REP 581). We reiterate our support for ASIC instigating the expert review conducted by Darren McShane.

AIST has advocated that there are two key objectives which should underpin RG 97:

1. Members' best interests must be met

Fees and costs must be able to be meaningfully compared by members.

2. Benchmarking of products must be capable of being conducted

The Productivity Commission¹ commented that the key indicator of system efficiency is an assessment of whether the system is maximising long-term net returns to members. The Commission went onto setting certain benchmarks and commented on the lack of data enabling this to occur.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry also identified the need for greater consistency and transparency in its final report.

AIST has strongly advocated that disclosure and data collection are naturally inter-related. Earlier calls by regulators for consistent data could have detected and therefore resolved problems now identified by the Royal Commission. We outlined examples within a recent submission² to APRA.

Any review of RG 97 begs the question whether the two objectives and basic consumer protection principles (as outlined in the RG 97 Industry Guidance) have been met. While the above two key objectives underpin RG 97, there are other basic consumer protection objectives which should generally drive disclosure and reporting. We outline these in an appendix to this submission, together with how meeting these objectives in superannuation has not been met.

¹ Productivity Commission (2019). *Superannuation: Assessing Efficiency and Competitiveness*. [online] Productivity Commission. Available at: <https://tinyurl.com/y9yloxll> [Accessed 26 Mar. 2019].

² AIST (2019). *Post-Implementation Review of the Prudential Framework for Superannuation: Data and Reporting Framework 25 January 2019*. [online] AIST. Available at: <https://tinyurl.com/ycfrxtht> [Accessed 26 Mar. 2019].

AIST appreciates that ASIC has deferred certain recommendations in the interests of not delaying implementation of other measures, but this means that the sector level issues – which will provide the greatest beneficial impact – have, yet again, not been dealt with.

We have expressed our concerns that the items of biggest value to members and system analysis have been deferred. Additionally, ASIC's response to technical issues has repeated problems which have occurred since 2014, but within a different context. We are concerned that learnings from the past 5 years have not been applied to the current consultation.

How property operating costs had been dealt with in the past not only caused a lack of a level playing field across asset classes, but a high degree of uncertainty about what type of costs were included and how far to drill down (e.g. the costs of providing shopping trolleys within a leased supermarket).

ASIC's current response to two issues will cause the same type of problem – where to draw the line:

- Intra fund advice - for example, are contact centre costs to be included, IT software updates, paper costs, a cup of tea provided to visitors) etc.
- Administration costs – administration costs are not static. They vary year on year and depend on whether administration is insourced or outsourced.

Hierarchy of policy issues to deliver against key objectives

While appreciating ASIC's deferral of certain issues, it is important when considering ASIC's response to consider which changes would be of the greatest value and impact to both members and benchmarking system performance. AIST believes there is a hierarchy of priority issues to be addressed.

Sector level consistency and comparability

AIST has been strongly advocating for sector level consistency within RG 97 since 2014:

- Platform consistency with superannuation.

We fail to understand why this issue keeps being deferred. It is important to state how important this issue is to members and system benchmarking. The facts speak for themselves:

By January 2018, the amount of funds under administration (FUA) held on platforms in Australia topped \$821 billion. That's an impressive compound annual growth rate of 10 per cent rate since January 2011. ... [M]ost of the FUA on these platforms are in superannuation products – 48 per cent in the accumulation phase and 32 per cent in the retirements phase.³

- Managed Investment Schemes (MIS) consistency with superannuation

...Since the introduction of Australia's mandatory retirement income scheme in 1992, the investment management industry with assets under management has grown by a compound annual growth rate of ten per cent. "⁴

Asset class consistency and comparability

- Property.



³ Netwealth (2018). *Platforms - the original fintech*. [online] Netwealth. Available at: <https://tinyurl.com/y5yv83yx> [Accessed 2 Apr. 2019].



⁴ Australian Government (2017). *Australia's Managed Funds 2017 Update Trade and Investment Note April 2017*. [online] Australian Government. Available at: <https://tinyurl.com/y6tkk5hg> [Accessed 2 Apr. 2019].




Calculation and other technical matters of consistency and comparability

- Performance fees.
- Implicit costs.

We outline each of these issues in detail:

Issue	Status	Details
SECTOR LEVEL ISSUES		
Platform exemptions		<p>ASIC has indicated in CP 308 that they do not plan to proceed with recommendations 17-21 due to concerns that this would delay other measures. AIST does not agree with ASIC’s approach in relation to these recommendations and believes that the current status quo – where platform disclosure is neither meaningful, nor a level playing field – should not be maintained. We also are uncertain about the confidence in the ability of platforms to comply with the Protecting Your Superannuation package of reforms.</p> <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none"> • Biggest impact item for members and system benchmarking deferred. • Level playing field across sectors and asset classes not delivered. • Lack of comparability. <p><i>Policy or legislative change required</i></p> <p>This can be achieved by a policy change (by ASIC instrument).</p>
Consistency between superannuation and managed investment scheme (MIS) requirements		<p>The current disclosure differences mean that there is a lack of a level playing field between MIS and super disclosure requirements. ASIC’s proposals build upon recommendations 3, 4, 5 and diagrams 6-1 and 6-2 in the McShane Report in implementing a redesigned fee and cost template, as well as consumer testing, but limited</p>

Issue	Status	Details
		<p>changes beyond that. AIST supports efforts to build consistency through better labelling and guidance, however with no guidance to fee and cost taxonomy or calculation methodologies, this may have limited effectiveness.</p> <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none"> • Biggest impact item for members and system benchmarking deferred. • Level playing field across sectors and asset classes not delivered. • Lack of comparability. <p><i>Policy or legislative change required</i></p> <p>This change requires both policy (via ASIC instrument) and legislative (via Corporations Regulations).</p>
ASSET CLASS LEVEL		
Consistency between asset classes		<p>Property is presently treated differently to other asset classes. ASIC’s proposal B6 sees property operating costs (along with borrowing and implicit transaction costs) not being required to be disclosed in PDSs and periodic statements. AIST supports these changes, however has recommended more work be undertaken.</p> <p><i>Basic consumer protection principles better met</i></p> <p><i>Policy or legislative change required</i></p> <p>This can be achieved by a policy change (by ASIC instrument).</p>
TECHNICAL MATTERS		
Performance fees		<p>ASIC has undertaken a considerable amount of work in relation to performance fees, with a recommendation to estimate performance fees by reference to the past financial years. AIST would prefer that an estimate be</p>

Issue	Status	Details
		<p>used to reduce uncertainty as well as counter-intuitive disclosure.</p> <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none"> • Lack of comparability. • Lack of consistency of comparability methods. <p><i>Policy or legislative change required</i></p> <p>This can be achieved by a policy change (by ASIC instrument).</p>
<p>Implicit cost information</p>		<p>The consultation paper makes several recommendations in relation to implicit cost information such as transaction fees and counterparty spreads. AIST continues to point out that implicit cost information is uncertain, and more work needs to be undertaken in respect of definitions prior to proceeding with some of the proposals in CP 308.</p> <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none"> • Lack of comparability. • Lack of consistency of comparability methods. <p><i>Policy or legislative change required</i></p> <p>This can be achieved by a policy change (by ASIC instrument).</p>
<p>Reserving</p>		<p>The treatment of reserves in the consultation paper is likely to lead to double counting. AIST suggests that the proposed clause 209A needs to be redrafted.</p> <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none"> • Lack of comparability. • Lack of consistency of comparability methods.
<p>Other matters</p>		<p>We have raised additional concerns in this submission in relation to the following matters:</p>

Issue	Status	Details
		<ul style="list-style-type: none">• Additional breakdown of fees and costs.• Simplifying periodic statements.• Clarification of amounts paid by third parties. <p><i>Basic consumer protection principles not met</i></p> <ul style="list-style-type: none">• Lack of comparability.• Lack of consistency of comparability methods.

Responses to proposals

Platform exemptions

The exemptions provided to platforms remains our highest priority item in this consultation. AIST believes that the avoidance of bringing platform disclosure into line with ordinary superannuation funds has the biggest impact on the effectiveness of these measures.

Our discussions in this section mainly relate to platforms used in providing superannuation products. Although some of our comments may be read in the context of non-superannuation platforms, this is very much a secondary focus of our comments. Note that we do not plan to respond to all the proposals contained in the paper.

Proposal D2: Platform disclosure.

This proposal would see the recommendations regarding platforms deferred until a later date, in order to progress work on the remaining proposals in this paper.

AIST is concerned by several issues in relation to this deferral, including the following issues:

1. Members are affected

We note that there are a number of members of funds who already have tolerated years of substandard disclosure in relation to platforms. We note that although AIST and others have pointed out the disclosure gap that exists between non-platform and platform superannuation products on multiple occasions, this deficiency still exists.

The reality is that as long as the exemptions for platforms continue to exist, there will continue to be a comparability problem between platforms and non-platform superannuation products.

As noted above, platforms are a huge portion of the Australian financial system and members can wait no longer for platforms to be brought into line with improved disclosure requirements.

2. The impact of further delays affects members further

AIST notes that part of this proposal is a commitment to undertake a review of platforms at a later point in time. However, no firm timeframes are given other than to commence possibly at the end of 2019, when the review of MDAs has been concluded. This is not acceptable. Work has been being undertaken on this project since 2014. However, during this time members continue to not be in a position to know the actual costs of their investments to the same extent as members invested in ordinary superannuation funds.

To continue for an unspecified period in this state is to deprive these members of the same rights that members of ordinary superannuation funds have. This is regrettable and it is also highly questionable: There are members of these funds who have their Superannuation Guarantee payments going into these accounts, after having chosen these funds as eligible choice funds.

3. Recommendation 20

Viewed in isolation, Recommendation 20 of the McShane report suggests that the fees and costs associated with investments available through a platform are “someone else’s problem”. We disagree, and point to the other recommendations 17-21 as a context through which this recommendation rests. The paper recommends Proposal C5 as a stop-gap. We will discuss this proposal further below.

4. The Protecting Your Superannuation package

The Protecting Your Superannuation Package was announced during the 2018 federal Budget, and was recently passed through Parliament as the *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018*. Part of the Bill requires superannuation funds – whether they are platforms or not is not specified – to comply with a number of laws, including a restriction on administration and investment management fees to no more than 3%.

We do not understand how the deferral of requirements for platforms is compatible with this. To put this a more accurate way, the rest of the industry cannot know for certain whether platforms are compliant with the requirements, if they will not be brought into line with the rest of the industry.

With this in mind, we express some doubts as to whether ASIC can proceed with this proposal to defer these recommendations, given the newly legislated requirements.

AIST believes that recommendations 17-21 from the McShane report should be proceeded with as soon as possible, and that ASIC should proceed to undertake their review of platforms immediately.

Proposal C5: Guidance on including a prominent statement in the ‘Fees and costs template’ for platforms

Proposal C5 is aimed at implementing Recommendation 20 of the McShane report. Recommendation 20 of the report was designed to be viewed within the context of the other platform recommendations in the report, and is evidently designed to provide clarification to investors that investments are provided by other entities. The proposal requires platform operators to provide a prominent statement that the fees and costs in using the platform only relate to gaining access to the underlying investments.

The recommendation was not designed to abrogate responsibility for appropriate reporting of the fees and costs associated with the investments. CP 308 (at paragraph 156) appears to acknowledge that the stop-gap nature of providing the disclaimer to members in platforms. However, the recommendation is clearly inadequate – platforms should be taking some ownership over the investments that they provide, and this clearly allows platform operators to step away from this once again.

AIST does not support this. This requirement appears to flip the onus of investigation back to members, when the assets themselves are, just like any asset in an ordinary superannuation fund, owned by the fund and subject to tax and other superannuation rules.

Consistency between superannuation and managed investment scheme (MIS) requirements

Alignment of super with MIS is AIST's second priority issue. Accordingly, greater transparency around this project is needed. AIST believes that ASIC should have consulted with industry in relation to the scope, timeframes and methodology under which it is undertaking the consumer testing.

ASIC's project to align disclosure regimes requires transparency. We support the proposal to improve consistency through better guidance, however we have concerns that with no guidance to fee and cost taxonomy or calculation methodologies, this may have limited effectiveness.

Proposal C1: Consumer testing some proposed changes

AIST is concerned that testing of disclosure is already underway in relation to proposals in CP 308. We note in particular that one of the proposals that is being tested is a proposal to merge administration and investment fees and costs into a single line item.

The major problem that we have in relation to the testing, is that we have not had access to what it is that is being tested, specifically what is being tested for or the type of testing being undertaken. We will shortly (at the time of typing this) lodge a separate submission to Treasury (in relation to retirement income projection disclosure), where we will highlight issues associated with ASIC's consumer testing in relation to the MySuper product dashboard, including the issue that testing appeared to only cover level 1 and part of level 2 of Kirkpatrick's evaluation framework.

The testing that appears to be being undertaken appears to be focus group testing that again, primarily provides level 1 evaluation.

AIST encourages thorough consumer testing of all changes to consumer-facing disclosure. However, we have significant reservations about what, without further detail, might be described as a “stamp collecting” exercise. A better approach might have been to agree on the information to be tested prior to testing.

In addition, regardless of the results that are produced, the testing of administration and investment fees and costs as a single line item is not necessarily something we would support. There are advantages to be gained by seeing how much one’s superannuation fund is splitting the costs between administration and investment, most notably the issue where funds can charge relatively expensive investment management fees for passive management. To combine these figures would obscure this.

Proposal C8: Consistent presentation of fee information in the ‘Fees and costs template’

AIST agrees that consistency can be improved through better guidance.

Proposal C9: Reducing differences between superannuation product and managed investment product fee disclosure

AIST agrees that the changes proposed in this paper will greatly reduce the difference in disclosure between superannuation and MIS, however we believe that this should be part of a future review to ensure that additional differences are reduced, and unforeseen consequences of these proposals are able to be identified.

AIST additionally believes that this review can be undertaken as part of the proposed review of platforms, and should therefore be undertaken immediately.

Proposal D3: Consistency in the way fees and costs information is incorporated by reference

AIST agrees with this approach. AIST has some concerns that material being incorporated by reference can be both difficult to find on websites, and not be logically displayed once it is found. However, we agree that this is a second level issue and should be dealt with at a later stage.

Proposal E2: Treatment of derivative financial products

AIST is generally supportive of this for the time being, however we note that this will continue to result in differences between superannuation and managed investment products. We are still unable to understand why hedging costs are not recognised as costs, when all other derivative costs are, for example.

Consistency between asset classes

Proposal B6: Removing property operating costs, borrowing costs and implicit transaction costs

AIST supports the removal of property operating, borrowing and implicit transaction costs from being required to be shown in PDSs and periodic statements, and brings direct property partly into line with listed property investment.

There are presently problems with ASIC's current approach to fees and costs disclosure for property. First, property as an asset class is treated differently to other asset classes. Second, listed property is treated differently to unlisted property. Third, there is no certainty or logical basis for including property operating costs (for example, inclusion of property management costs that can be met by the tenants of that property).

AIST continues to recommend that property should not be treated differently to other asset classes. There should be no difference in the treatment of listed and unlisted property. There should be no difference between the treatment of property and infrastructure as asset classes. We have the concern that members may actively select against a fund that invests in direct property due to an incorrect perception that these costs are extremely high when compared with other funds with differing investment arrangements.

We welcome the commitment by ASIC to ensuring that property operating costs are removed from fee and cost summary, as well as the additional details tables. Fees are part of the equation, however we agree with ASIC that costs such as property operating costs are better linked to investment returns, rather than abnormally inflating investment management fees.

Performance fees

Proposal B8: Removing the distinction between performance fees and performance-related fees

We support consistency between the treatment of performance fees and performance related fees. However, the use of alternate methodologies adds complexity and does not aid in meeting the objectives of comparability or transparency.

Having fund managers estimate performance fees is problematic for a number of reasons. Whilst the rate of performance fees that are to be charged should be displayed on a prospective basis - for comparative purposes (and the \$50k example) - it is only feasible to show these on a retrospective basis. A prospective approach is too open to gaming. Both performance and performance-related fees need to be shown along-side returns. Having these fees disclosed in a

“Performance” section of the disclosure will assist in members understanding the context of these charges.

Proposal B9: Calculating performance fees

Whilst we agree with this proposal in principle, there are a number of practical limitations on the ability to calculate performance fees going back a five-year period.

We have concerns that there are material issues with quoting performance fees as an average, and consider that it is not a good method of estimating performance fees.

We are concerned about the proposal to use an average over the last five financial years to calculate performance fees. Taking into account factors such as the appointment and removal of different investment managers, changes to asset allocations and increases in funds under management, historical performance fees are unlikely to produce accurate estimates of these fees for future years.

Performance fees can be calculated a number of different ways. Alternatively, performance fees may not be in place at all. Over a five-year period, it is possible that arrangements may change, and such arrangements may include the following:

- The product has less than five years of performance history;
- Performance fee calculation methodologies have changes during the five-year period;
- Performance fees were imposed for the first time (or removed) during that five-year period;
- The number of assets internally managed changed during that period;
- The product’s strategic asset allocation has changed and with it the allocation to managers which charge a performance fee;
- Funds under management have increased or decreased; or
- A successor fund transfer has taken place and the larger fund did not have performance fees in place prior to the transfer.

This list is not exhaustive. It should be noted that where funds have consistently outperformed, this has the effect of inflating performance fees, and it may be that investors perversely react unfavourably to this.

There are other problems with the methodology that is being proposed in CP 308 around underperformance. We are aware of funds employing managers who have lengthy periods of underperformance and have undergone periods where they are “clawing back” performance fees from their fund managers. To defuse the confusion that may face members from seeing negative values, ASIC has written at paragraph 103 that the “calculated average figure should not be

negative”. Bumping up a fund’s average performance fee expense to zero from a negative figure is, we believe, not an intended outcome of showing average performance fees, and is potentially misleading.

This unfortunately highlights another issue. Over the long term, it should be expected that the average performance fee should tend towards zero for a number of reasons, the main ones being requirements (commonly stipulated in contracts with fund managers) that a hurdle be met prior to paying a performance fee, and the need to recoup past years’ underperformance prior to paying a performance fee.

It follows that if a fund manager is meeting their targets on average, the performance fees for the period covered will average out at zero. Coincidentally, this would be the figure quoted for routinely underperforming managers who might be in clawback for the entire period.

We note that under Proposal B10 a super fund trustee would have scope to give a further explanation in the Fees and costs details (formerly the Additional explanation of fees and costs) if it believes the average performance fees figure based on the previous five years is not representative for the coming period. The impact of this explanation would be limited, particularly where the historical average figure appears in a shorter PDS and the explanation appears separately in the fees and costs incorporation by reference (IBR) document.

Alternatives based on forecasts or on actual fees for the most recent financial year may be more reliable. However, we also noticed that these may be prone to gaming, or in the instance of actual fees for the past years, subject to fluctuations.

Given that all other figures are presented on a year-to-year basis (for example transaction costs) it would be inappropriate to isolate performance and performance-related fees to be shown on a different basis. We believe this would lead to a lack of consistency and comparability.

Perhaps the better approach would be to provide the entire Performance section of the disclosure on both a 1 year and 5 year basis.

Longer timeframes may also be considered at a provider’s discretion – however we are cognisant that many products will not have been existence for this timeframe, which will result in difficulties for comparison purposes.

We do also note that member testing is required.

Some funds have noted that their approach with respect to performance fees has been to best reflect the experience of members as reflected in the unit price. For example, if a performance fee/ carried interest is accrued over a year, even though nothing is realized, the fund would

include this accrued amount in our calculations as the effect of the accrual on the member is as if it had been paid.

Under the proposed approach, we would like to understand whether it is the average of the accrued amounts, or actual amounts realised over the past five years (if a 5 year period is included) that would be used. There needs to be a consistent basis for calculation.

One other consideration is that, if the requirement is still that the actual historical amounts be disclosed in members' annual statements they may have trouble reconciling this back to PDS disclosures which may in turn create some confusion.

We think an average of the past 5 years could be an optional, additional disclosure rather than the prescribed approach.

For the fee example, and given the variability in performance fees, it would be helpful if the performance-related fee component could be shown separately so that members can distinguish from the more 'base line' fees and this variable component which is related to performance.

Proposal B10: Disclosing performance fees

We do not plan to respond to this proposal beyond a general statement of support for the proposal.

We note in paragraph (e) that the issuer would be allowed to provide a statement where they believe that the average figure is not representative for the coming period. As we believe that this is more likely to be the case than not for any given period, we would support a more general statement similar to past performance fees are not necessarily a predictor of future performance fees. In any event, the impact of this explanation would be limited, particularly where the historical average figure appears in a shorter PDS and the explanation appears separately in the fees and costs incorporation by reference (IBR) document.

Proposal D5: Explaining transactional and operational costs to consumers within the context of information about returns

Although we do not plan to formally respond to this proposal, we believe that this is a considerably important issue and should be followed up to ensure that it is not forgotten. This proposal should be reviewed within the context of Proposal C2, which we have addressed below.

Proposal D6: Calculating and disclosing performance fees

We do not plan to respond to this proposal other than to refer to our response to Proposal B9.

Proposal C2: Developing additional resources and information for consumers

Aside for the support for emphasising the importance and relevance of fees and costs in a context of overall net returns, AIST does not plan to respond to this proposal other than to re-iterate that we believe that this is a considerably important issue and should be followed up to ensure that it is not forgotten.

Implicit cost information

Proposal B5: Transaction costs (net) as a separate line item in the ‘Fees and costs template’ and in the ‘Example of annual fees and costs’

AIST supports the disclosure of explicit transaction costs and counterparty spreads as separate line items, as well as their inclusion in the cost of product information. We support the exclusion of counterparty spreads from other fee and cost information to prevent double counting.

Proposal B7: Inclusion of counterparty spreads

This recommendation is based on the proposal in REP 581 to treat counterparty spreads (but not other implicit transaction costs) on the same basis as explicit transaction costs. Despite this background, we are concerned about the lack of clarity on the meaning of “counterparty spreads” in Consultation Paper 308. If parties are unsure of the meaning of counterparty spreads, they are likely to report a zero figure.

We are also uncertain why other implicit transaction costs might be treated differently from counterparty spreads.

We do not agree that that counterparty spreads may be readily and objectively ascertainable. We note that this is particularly an issue where the asset is an over the counter (OTC) asset which is not available through an exchange. These assets are generally obtained through counterparties, which may charge their own bid-ask spreads which may vary, even for the same security. An example may be an instance where a total return swap is entered into with two separate counterparties:

	Counterparty A	Counterparty B
Bid	\$10.00	\$20.00
Ask	\$20.00	\$25.00
Inferred midpoint	\$15.00	\$22.50
Spread	± \$5.00	± \$2.50

This may potentially incentivise members to seek out the counterparty charging the lower spread, rather than the transaction which provides the better bid or ask prices.

The consultation process may produce wide variations in suggested definitions and views on the kinds of products and markets to which counterparty spreads may apply. If so, we believe the question should be set aside so that it does not cause a delay in implementing the other, important changes outlined in the Paper.

AIST does not yet support the proposal to include counterparty spreads in transaction costs until they are sufficiently defined at Sch 10.

Reserving

Proposal B11: Clarifying the treatment of costs paid out of reserves

We are greatly concerned that there is likely to be double counting in relation to reserves. The operation of reserves involves crediting fees to reserves and debiting operational costs from reserves. We believe that the proposed clause 209A needs to be amended.

The main problem is that the true costs do not coincide with the administration fee collected. They vary from year to year, and the amount that they vary by can also differ between fund to fund. A general rule of thumb is that externally administered funds have higher fluctuations than internally administered funds.

Reserves are used to ensure that costs are allocated when members required those costs to be met. This doesn't normally coincide with the collection of administration fees, however trustees are required to consider members' equity in both the meeting of member costs as well as the collection of administration fees. Costs of legislative change may, for example, be recouped from reserves for years into the future. A rise in administration fees may result in several years of adding to reserves before reserves start to be depleted.

A separate consideration is the requirements for a specific reserve – the Operational Risk Financial Reserve (ORFR). It must be maintained at a certain level, and must be continually topped up.

Ideally, reserves could be treated in the same way as retained earnings in an ordinary company. This means that if the trustee determines that the fund should maintain a level of capital to reinvest in providing better services, products or technology to members then it should be able to do so. In this regard it is effectively a capital management decision.

Additional matters

Proposal B1: Changing the superannuation product 'Fees and costs template'

AIST supports allowing issuers to include an additional breakdown of investment fees and costs, and the same breakdown should be allowed for administration fees and costs. Such breakdowns should not be contained within the summary in the PDS, but elsewhere, e.g. website, fee and costs guide. However, we are concerned about making certain elements requirements.

We note in particular the treatment of intrafund advice.

Intrafund advice is a service which is collectively charged, along with other services, such as non-advice contact centre services, administration services, written information requests, statement printing etc.

CP 308 attempts to differentiate "intrafund advice" from "personal advice", and thus presents its argument in a confusing way. Although ASIC's Information Sheet 168 (INFO 168) appears to clarify ASIC's position that intrafund advice is normally a subset of personal advice, we point out that general financial product advice does not suffer from the collective charging restrictions of section 99F and therefore the material at paragraph 60 of CP 308 is irrelevant.

This is mystifying. We reiterate that intrafund advice is a service to members regarding their own investment, and should be treated in the same way as other fund services.

Proposal B4: Simplifying periodic statements

The proposal to 'gross-up' administration fees is fraught with problems. A number of funds do this differently and pass on the tax benefits of charging member fees in a variety of different ways which may not be captured if only limited methods of returning this tax to members is counted.

We consider that the 'gross-up' of the administration fee for taxation purposes will be confusing and misleading for the consumer. The part that is most relevant from a member's perspective in terms of administration fees is the amount that will actually be paid from the member's account.

Proposal C6: Clarifying in RG 97 the treatment of amounts paid by third parties or offset against other amounts

AIST is uncertain that we can comment on this without further details.

Appendix: Key objectives, transparency and data reporting

Key objectives

The bottom line to policymaking in this important area is the need to focus on what elements of fee and cost disclosure has the biggest impact on members. An issue that AIST has raised from the outset (and what was demonstrated in the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services*) is that the issues facing consumers is replicated in data collection and reporting. Consumers cannot hope to be able to have an informed approach to selecting the appropriate products for them without this, and appropriate ways to benchmark this.

AIST has continually maintained in all consultation to date that there have not been a set of clear principles stated in relation to fee and cost disclosure, which would include members being able to compare and the enabling of system analysis. We note that Darren McShane agreed with this observation in REP 581. We also note that Mr McShane agreed with our observation that the information provided has a number of other difficulties including meaningfulness, accessibility, comparison ability and system analysis.

We underline the need to benchmark fees and costs in the context of net returns. We note that without appropriate benchmarking, there is no capability to know whether members will be placed in an optimal position with respect to their retirement savings.

A number of other technical changes have also been made. AIST underlines the recommendations made in this submission with a comment that these must be implemented for all members, not just MySuper members, and not just non-platform superannuation funds.

AIST's approach to fee and cost disclosure assumes that there are multiple objectives in ensuring that a robust disclosure environment is in place:

Objective 1: To better protect the retirement savings of Australians.

Australians are mostly in defined contribution schemes and carry the risk of investments and reduction of benefits through fees. At June 2012, defined contribution scheme balances stood at 87%⁵.

⁵ Willis Towers Watson (2018). *Thinking Ahead Institute: Global pension assets study 2018*. February 2018. [online] London: Willis Towers Watson, p.34. Available at: <http://tinyurl.com/y29s3eqv> [Accessed 26 Mar. 2019].

Objective 2: To ensure greater efficiency and competition within Australia's superannuation system.

In its submission to the Financial Services Inquiry, the Reserve Bank of Australia⁶ voiced its concern that the current fee structure was not promoting efficiency or competition (and that Australian superannuation fees are higher than in many other OECD countries).

Objective 3: To counter managers maximising their own interests.

Treasury commented in its submission to the Financial Services Inquiry⁷ that managers maximising their own interests additionally adds to driving higher fees.

Objective 4: To overcome hidden commissions and insider trading.

As the OECD notes⁸ a combination of being in defined contribution funds and having member choice can lead to, for example, hidden commissions and insider trading. The OECD notes this problem is exaggerated when the pension providers are commercial financial institutions. Disclosure is a critical tool for managing this risk.

Whilst there have been other reviews in place examining the level of fees that are being charged, the issue of how best to disclose these amounts to Australians is being examined through the work being undertaken as part of this process. Once again, AIST underlines the importance of ensuring that all Australians are able to properly ascertain how much it is that they are paying for the management of their retirement savings.

Transparency

The history of transparency in superannuation is not a good one, particularly in the retail sector. We are aware of a number of instances through history where legislation and regulatory solutions have been required in order to ensure that superannuation fund members know what it is that

⁶ RBA (2014). *Submission to the Financial System Inquiry*. March 2014. [online] Canberra: Commonwealth of Australia. Available at: <http://tinyurl.com/y2bktqaf> [Accessed 26 Mar. 2019].

⁷ Treasury, The (2014). *The Department of the Treasury's submission to the Financial System Inquiry*. 3 April 2014. [online] Canberra: Commonwealth of Australia. Available at: <http://tinyurl.com/y6yfvrgq> [Accessed 26 Mar. 2019].

⁸ OECD (2011). *G20 High-level principles on financial consumer protection*. October 2011. [online] Geneva: Organisation for Economic Co-operation and Development. Available at: <http://tinyurl.com/lcklllz> [Accessed 26 Mar. 2019].

they are getting. It was not all that long ago that commissions on investment and insurance products were not appropriately disclosed by bank-owned super funds.

Transparency projects have been under development in some cases since the Stronger Super reforms and are still being worked on. The need for consistency and transparency must be a much higher priority of Government. This is particularly important for retirement products, due to their higher account balance, but also because these products will be relied on by retirees to last the rest of one's lifetime.

The need for transparency extends beyond fees to a number of areas. There is presently a list of projects being undertaken in the financial services industry aimed at improving disclosure, including:

1. Portfolio holdings disclosure, presently in front of the House of Representatives, aims to look down into investments in a superannuation fund so that members can have an informed view of what it is that they are investing in.
2. Website disclosure mandated by section 29QB of the *Superannuation Industry (Supervision) Act 1993* (the "SIS Act") requires superannuation fund trustees to maintain certain items of information, such as in relation to directors, board meetings and annual reports online and strictly governs when these must be updated.
3. Product dashboards, presently mandatory for MySuper investment options and under development for choice investment options require the maintenance of a rigid information set which is designed to promote comparability between investment products.
4. Reporting requirements mandated by section 29QC of the SIS Act are designed to ensure that information provided to the prudential regulator as part of fund reporting can be equated with similar information provided to the financial services regulator.

Fee and cost disclosure outlined in *Regulatory Guide 97: Fee and cost disclosure* (RG 97) has been under consideration for some time.

Concerns regarding carve-outs and preferential treatment for certain products paint a picture of an industry where disclosure is inconsistent.

The fact that so many disclosure issues are either under development or under review accurately highlights issues related to disclosure in the superannuation industry. Common features of issues related to the projects above include the inability for members to properly consider the impact of related party payments, particularly where investments are placed by fiduciaries with associated entities. Another issue is the opacity of pricing related to use of pooled investments. There are presently no limits as to how many layers of pooled investments money can be invested through, however there is a limit to how far regulation appears to want to look. It goes without additional

clarification that a “ticket is clipped” at every level of investment pooling, and that associated entities are often used.

According to the World Bank⁹, a core element of improving pension system efficiency is to ensure that costs which do not contribute to increased returns are reduced. They go on to note that ‘competition by itself appears to be inadequate to drive lower costs if individual choice alone is involved. Lack of transparency is a big issue in determining costs.’¹⁰

We have consistently maintained since 2016 that despite the buzz of activity in this space, there is still very little idea of how all these projects tie together.

Data and reporting

In a recent submission to APRA¹¹, we pointed out that had APRA gathered and analysed appropriate data, it is likely that a number of identified instances of misconduct from the Royal Commission could have been remedied sooner. However, we made it clear that this was symptomatic of a broader malaise, and we note that data and reporting is not aligned.

Getting the data right is critical, and we note that left out of the work in relation to fee and cost disclosure is the need to communicate the disclosed data to third parties, in particular regulators, in a form that is meaningful.

One of the recommendations that we made as part of our submission was to highlight the need for a comprehensive data reporting framework. We noted in that submission that in addition to APRA’s focus on satisfying a number of reporting standards, there was not much more, and that:

...while the reporting standards may provide some useful information about the operation of the system, they are not tied to any benchmark assessment of system performance, nor does any such benchmark currently exist.

⁹ The World Bank, (2016). *Outcomes based assessment for private pensions: a handbook*. [online] The World Bank. Available at: <https://tinyurl.com/keyrhr5> [Accessed 11 Apr. 2017].

¹⁰ The World Bank (2016), p.21.

¹¹ AIST (2019). *Post-Implementation Review of the Prudential Framework for Superannuation: Data and Reporting Framework*. AIST Submission to APRA, 25 January 2019. [online] Melbourne: Australian Institute of Superannuation Trustees. Available at: <http://tinyurl.com/ycfrxtht> [Accessed 26 Mar. 2019].

A comprehensive data reporting framework must articulate what information is needed to benchmark system performance and articulate how this information supports an assessment of system performance and whether members' needs are being assessed.

We consider that fee and cost disclosure must form part of this data set.

One further thing that we have noticed in relation to CP 308 is the lack of a project timeline. This must be rectified.
