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Australian Securities and Investments Commission
Level 5, 100 Market Street
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By email: feeandcostdisclosure@asic.gov.au

Dear Ms Nielsen,

Industry Super Australia (ISA) welcomes the opportunity to provide comment on ASIC Consultation Paper 308 (CP 308) Review of RG 97 Disclosing Fees and Costs in PDS and Periodic Statements, relating to proposed changes to Regulatory Guide 97 (RG 97).

In what follows are some general comments on the consumer disclosure regime in superannuation and then more specific comments on the key issues. ISA will not be addressing every question set out in CP 308.

Many of the proposals in CP 308 have considerable merit. However, there are many more significant and further reforms that ASIC has neglected to adopt following the Darren McShane Expert's review, alongside considerable consultation with industry. In reality, the Expert's report should have signalled to ASIC that this area required significant law reform and redesign so that it worked in the best interests of super fund members and investors.

Superannuation disclosure has been a difficult regulatory area with far too much emphasis placed on disclosure doing the heavy lifting of protecting consumers.

Superannuation is unnecessarily complex, it is compulsory, and effective consumer engagement is persistently low. Since the Wallis Inquiry, our disclosure regime has operated on the principle that 'the more that is disclosed the better for the consumer', rather than on the basis that better decision-making on the part of consumers would be facilitated by meaningful disclosure combined with good product design by providers who take seriously their fiduciary obligations to members. This can turn superannuation disclosure into a risk management exercise for licensees instead of valuable information for consumers. This round of consultations, and the underlying review and proposed reforms, reflect the reality that the current disclosure regime has not worked in the best interests of superannuation members.

ISA therefore welcomes ASIC's motivation to try to improve disclosure of fees and costs to members.

RG 97 represents one aspect (albeit a central one) of a broader disclosure regime that has recently been the subject of other reviews and law reform. This includes:

- the recently-passed *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* – specifically, the upcoming impact of fee caps on fee and cost disclosure;

- significant findings by the Productivity Commission in its final inquiry report on superannuation about significant gaps in APRA superannuation data (including investment costs); and

- a Banking Royal Commission final report which highlighted unfortunate case studies in which superannuation members were misled and did not have the appropriate information to determine this or make more informed decisions.

It is important that any proposed changes to RG 97 factor in, and account for, such developments. We are not convinced that ASIC, in its desire to finally settle RG 97, has necessarily taken the time to fully incorporate the implications of these developments and reforms into its thinking on RG 97.

Reflecting our position in previous submissions, by creating inconsistent disclosure requirements for different entities, RG 97 has undermined the ability of consumers to make simple 'apples-for-apples' comparisons between products – a clear obstacle to what should be the central objective of an effective disclosure regime.

Instead, the disclosure framework outlined in RG 97 seems to accept that members are not the key audience, but that experts will process cost information and provide various interpretations for consumer use. In this context, it is notable that in consultations with industry, ASIC found that even "*financial advisers find RG 97 hard to work with*," with it "*not [being] clear what fees and costs should be included in a statement of advice.*"[1]

As a consequence, ASIC Report 581 concluded that the member experience of comparing products under the RG 97 regime is "*a laborious and time-consuming exercise that most consumers would likely avoid or short-cut.*" Tellingly, these difficulties were found to be even more pronounced in the case of non-default (i.e. choice) products.[2]

Unfortunately, the proposed reforms will not adequately address these important problems.

Of particular concern, is a lack of action on the platforms exemption and the inconsistent treatment of property investments between real estate investment trusts (REITs) and super funds that invest directly in property. ISA's position on both of these key issues have been detailed here and are consistent with our previous submissions on RG 97. ISA believes the most effective disclosure regime would be one that places a *net returns measure* – incorporating the effect of fees and costs – at its core.

We know that fee and cost categories can be gamed. An example of this can be seen with retail funds that currently choose to report no investment fees to APRA. A net returns measure cannot be gamed because charging, regardless of how/whether a fund chooses to label it, erodes the overall net return. A net returns measure would also be more consumer-friendly. Allowing consumers to compare products on a like-for-like basis would significantly enhance the likelihood of good decisions being made.

Additionally, focussing on net returns would negate the ability of some entities to take advantage of fee disclosure exemptions (such as those relating to platforms under the current regime) to make their products appear cheaper and more attractive to consumers.

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[1] *ASIC Report 581. Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (July 2018), p.174

[2] *Ibid.*, p. 9

Finally, a net returns approach is consistent with benchmarking fund performance and would be consistent with an enhanced Member Outcomes test, potentially deployed by APRA.

ISA's specific observations on CP 308 are outlined below.

Property operating costs

- ISA supports **Proposal B6** (to no longer require that property operating costs, borrowing costs, and implicit transaction costs be disclosed in PDSs and periodic statements).

Platforms exemption

- ISA strongly opposes the lack of action on addressing the platforms exemption, which has led to substantial comparability concerns. While we acknowledge ASIC's announcement of a review later in the year of platforms more generally, if RG 97 is implemented in its current form (before a decision is made on platforms) then ASIC will have facilitated a disclosure regime which is potentially misleading when consumers compare a super master trust with a superannuation platform offering (IDPS or IDPS-like).

- As ISA has previously expressed,[3] it is unclear how platforms can be classified as not being interposed vehicles, given that:

    1. platforms sit between the investor and the asset that generates the return; and

    2. 70 per cent or more of platform assets are financial instruments.

- No convincing arguments have been made as to why the exemption should remain. Failure to address this issue appears driven by a desire to avoid inconveniencing platform providers, instead of a desire to protect members.

- In this context, it is important to remember that superannuation money in platforms is part of the SGC framework. All entities that receive compulsory super contributions – and are subject to the relevant accompanying obligations – should be required to disclose their fees and costs in a manner that allows for clear comparability.

- ASIC's approach to dealing with the issue is to standardise the requirement for platform providers to include a "prominent statement" advising that fees and costs cited in a PDS relate only to *gaining access to the underlying investments* and do not cover the associated costs themselves (**Proposal C5**). However, this is inadequate. Such a development would only entrench the problems that presently mark the consumer comparison exercise (acknowledged in **Report 581**, as referenced above) and consumers would still need to make their own calculations as to the total fees they would be liable to pay when investing via a platform. In effect, the "prominent statement" simply discharges responsibility onto consumers which, in the context of a compulsory superannuation system, is highly likely to lead to poor outcomes.

Real Estate Investment Trusts (REITs)

- As with the platforms exemption, the continued exclusion of REITs from full disclosure requirements under the assets test in RG 97 is regrettable. ASIC's failure to propose reform on this matter is a lost opportunity in terms of creating an effective disclosure regime.

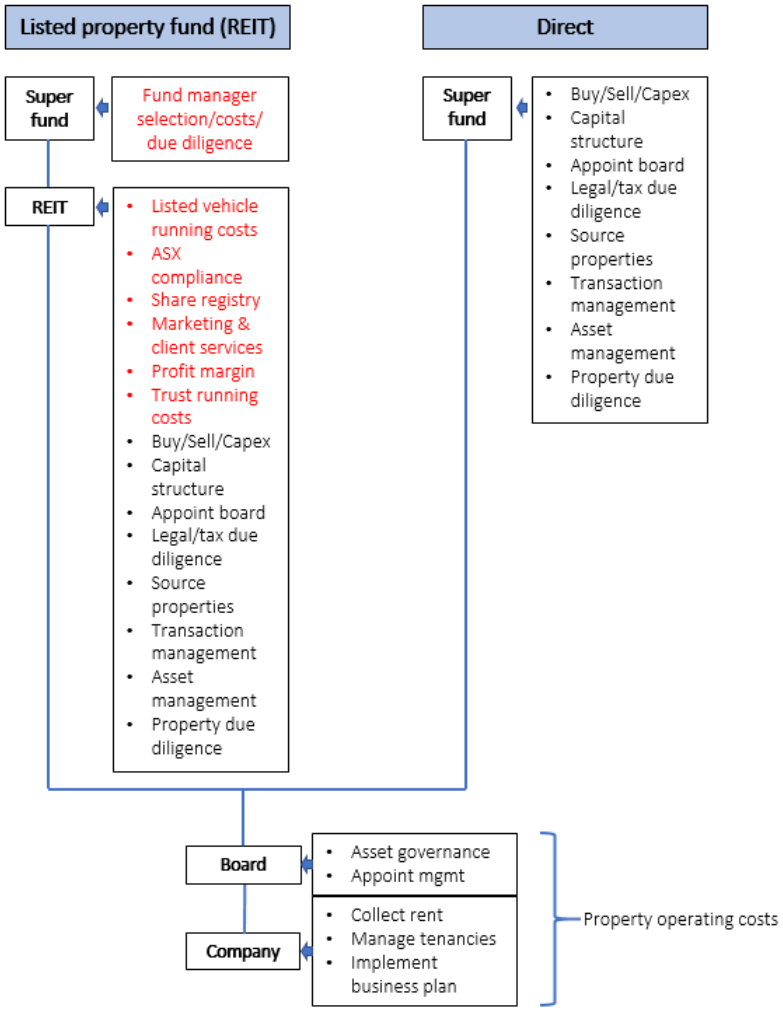
[3] Letter from ISA to Darren McShane and Kathy Nielsen, 6 February 2018.

- As we have noted in previous consultations,[4] the underlying justification for the exemption – that an investment via a REIT does not necessarily imply the holder is seeking exposure to property – defies logic. Even so, regardless of the motivation behind the investment, holdings in REITs incur indirect costs that cannot, and must not, be neglected in the context of member-facing disclosure. Again, ISA makes the point that the REITS exemption could potentially lead to the absurd scenario in which one investor holding a property interest would receive disclosure of indirect costs, while another holding the same interest via a REIT would not; giving rise to unacceptable and wholly avoidable cost-comparability problems for consumers.

- This impact is demonstrated in Figure 1. Not requiring a superannuation fund investing in property via a REIT to disclose the costs associated with the REIT's management results in a clear distortion.

- Importantly, too, this scenario factors in the future impact of **Proposal B6**. Under current settings, the direct investment would appear even more expensive, having to take into account the property operating costs, whereas the listed investment would not. Accordingly, while we reiterate our support for removing the requirement to disclose property operating costs, it is clear that this will only partly address the unequal treatment of property investments between listed and direct holdings.

Figure 1. Indicative REIT indirect costs not disclosed under RG 97 (in red font)



[4] *Ibid.*

Treatment of reserves

- ISA is concerned about the implications of reforms relating to reserves (**Proposal B11**). Specifically, it is unclear why funds should be required to disclose both money *going into* reserves and money being *paid out of* reserves.

- It is important to highlight that fees charged to members are credited to reserves, and operating costs are debited from reserves. Funds must consider member equity when recovering costs associated with product development, technology uplift and legislative changes. Reserves are used to align the recovery of costs to when members actually receive the benefit from those costs. For example, a significant legislative change may result in a large cost to the fund in one particular year. However, the benefits realised by members may well be some time into the future. Therefore, the way in which a fund may recover costs will not necessarily match the timing of the expense (the timing of expenses and recovery are independent).

- Another consideration is how a reserve is initially funded or maintained at a level deemed appropriate. If a fund decides to fund a reserve through shifting funds from one reserve to another, this should not be considered a fee to the member. For example, the ongoing requirement to maintain the Operational Risk Financial Requirement (ORFR) at 28bps requires funds to continually 'top-up' their ORFR.

- Reserves should be treated in the same way as retained earnings in an ordinary company. This means that if a 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.

Consumer testing

- ISA has concerns about the nature of the consumer testing (**Proposal C1**) being undertaken, as described by ASIC to stakeholders at the recent consultation roundtables.

- As ISA understands it, this testing has primarily taken the form of focus groups and interviews eliciting participants' general impressions of a limited number of the proposed changes (chiefly the simplification of categories in the fees and costs template).

- A more productive approach would have involved systematically testing the usability of the updated disclosure regime. Ideally, participants would be asked to use PDSs to compare the costs of different product types (e.g. a product offered by an industry super fund vs an IDPS or IDPS-like product) under the proposed updated regime. It is ISA's contention that, given the lack of action on factors such as the platforms and REITs exemptions, such comparison-based activity would prove challenging (fee category simplifications notwithstanding).

- Nonetheless, given that the overarching objective of disclosure should be to facilitate the making of informed decisions, any consumer testing of the proposed changes should be specifically designed to test if the disclosure actually results in good decisions.

'Zero-fee' gaming of RG 97 by managed investment schemes

- The current disclosure regime's focus on fees and costs is creating perverse incentives for investment managers to game RG 97 regulations; hiding fees and costs to make certain products appear more attractive to consumers.

- For example, ISA has become aware of several managed investment schemes that are branded as 'zero-fee' products. These products generally use swaps to guarantee benchmark returns. Under these swap arrangements, services are provided for zero management fees but, in return, if the fund outperforms the benchmark the fund pays the investment manager the outperformance.

- Under RG 97.278 and RG 97.279, such arrangements should in fact be reported as income offsets or income sharing arrangements.

- Arguably, the result of this behaviour is that some trustees may be misleading members as to the true cost of these zero-fee (or other 'low-cost') investment options.

Further to these key issues, the following table sets out ISA's responses to selected additional proposals made in CP 308.

Proposal	ISA comment
B1. Changing the 'fees and costs template'	• Merging 'indirect costs' into the appropriate relevant category to which they relate (either administration or investment fees) is supported. Doing so would directly address industry gaming, by removing the ability of trustees to frame certain costs as indirect costs, seeking to make their standalone administration or investment fees appear lower when compared to competitors. • However, the proposal that entities should disclose administration fees as gross of any tax implications should be reconsidered because such a change may confuse, and potentially mislead, members. The important and meaningful factor from a consumer's perspective with respect to administration fees is the amount that will actually be deducted from a member's account. • ISA supports the proposal to group together 'ongoing annual fees and costs', separate from 'member activity related fees and costs.' Such a change would make it simpler for consumers to understand the fees they would be liable for on an ongoing basis, and removes the potential confusion arising from members incorrectly adding together ongoing and one-off fees.
B3. Including 'cost of product information'	• Requiring super funds and managed investment schemes to include 'cost of product information' for each investment option is a good start but does not go far enough. A net returns measure is the simplest and most constructive way for consumers to be able to compare products against each other. • Further, the fact that certain entities will continue to be exempt from fully disclosing cost of product information – such as IDPSs, via their ability to rely on the "prominent statement" featured in **Proposal C5** – significantly undermines the proposal's effectiveness. • In response to **question B3Q3**, incorporating a $5,000 contribution on the last day of the year in the 'Example of annual fees and costs' for all superannuation products will assist consumers make decisions and compare products.

Proposal	ISA comment
	▸ We note that while ASIC has rightly acknowledged MySuper products are not able to charge contribution fees, this is not the case for choice products. Accordingly, while contribution fees are not currently taken into account when calculating fees and costs for disclosure purposes, ensuring that trustees of choice products will need to disclose them is a positive step in enhancing consumer comparability.
B4. Simplifying periodic statements	▸ While reducing the number of data points relating to fees and costs in periodic statements will make it simpler for members to understand the total fees and costs they have paid in that period, greater emphasis should be placed on contextualising how those fees and costs have impacted on net returns. A net returns measure (in both PDSs and periodic statements) should be the focal point of a reworked disclosure regime.
B7. Inclusion of counterparty spreads in transaction costs	▸ ISA does not support the inclusion of counterparty spreads in transaction costs. ▸ It would appear that ASIC's view is based on OTC markets not having a central exchange, such that there is no agreed bid and offer. ▸ In taking this stance, we are concerned that introducing counterparty spreads as part of RG 97 disclosure has the potential to encourage some undesirable outcomes for members. ▸ Specifically, assume the following scenario for a total return swap: Counterparty A (Bid 10; Offer 20) - Mid is therefore 15 - Spread is +/- 5 Counterparty B (Bid 20; Offer 25) - Mid is therefore 22.5 - Spread is +/- 2.5 If a fund transacts vs Counterparty A, it pays the offer of 20 and registers an RG 97 cost of 5. However, if the fund transacts vs Counterparty B, it pays the offer of 25 and registers an RG 97 cost of 2.5. Although the best outcome for members is to transact vs Counterparty A, the best cost outcome for the fund is to transact vs Counterparty B.

Proposal	ISA comment
C11. Developing and implementing a surveillance strategy	▸ Surveillance activity by ASIC to monitor the level of compliance with disclosure obligations is supported. However, it is premature to develop and implement such a strategy when the disclosure regime is ineffective, as it does not allow for simple comparability between all product types.

Once again, ISA thanks ASIC for providing an opportunity to comment on CP 308. We look forward to engaging with ASIC on the problems and issues identified in this submission.

Yours sincerely,

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