

Submission to ASIC —
Consultation Paper 308 -
Review of RG 97
Disclosing fees and costs
in PDSs and periodic
statements

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Dear Kathy

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

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to ASIC's Consultation Paper 308 - Review of RG 97 Disclosing fees and costs in PDSs and periodic statements (CP 308).

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 15.6 million Australians with superannuation.

ASFA strongly supports the underlying policy intent of transparent and consistent disclosure of fees and costs to members. We have provided specific feedback and comments on Consultation Paper 308, the draft amendments to Schedule 10 and the draft updated Regulatory Guide 97 on the attachment below.

If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4021 or by email fgalbraith@superannuation.asn.au.

Yours sincerely

Fiona Galbraith
Director, Policy

General comments

1. Achievement of underlying policy intent and desired policy outcomes – consistency, comparability and simplicity

ASFA strongly supports the underlying policy intent of transparent and consistent disclosure of fees and costs to members.

There are differing views, however, as to the nature and extent of fees and costs disclosure which is meaningful to consumers and able to be used appropriately by them to their benefit. Currently there is a great deal of confusion among consumers, and advisers, as to how to interpret and apply the disclosure of fees and costs.

Furthermore, the diversity and complexity of investment structures and options can make it difficult to achieve comparability.

Simplicity of disclosure is important for consumer comprehension and understanding.

An appropriately designed regime can not only serve to aid consumer outcomes but has the added benefit of reducing compliance costs and mitigating the scope for gaming. An inappropriate regime risks the possibility of confusion among consumers, including through creating a false sense of precision, and may even mislead consumers, while rendering compliance difficult and costly to achieve.

Given this, we appreciate the difficulties faced by ASIC in revising RG 97. ASFA and the industry are keen to ensure that the final requirements are clear; easily able to be applied; keep additional compliance costs to a minimum and, most importantly, produce consistent outcomes for consumers.

ASFA is keen to support the development of an appropriate fee and cost disclosure regime which produces consistent, comparable, simple and useful outcomes for members.

2. Need for appropriate, comprehensive consumer testing

ASFA supports the need for consumer testing.

It is imperative that any such testing be comprehensive and appropriate. The scope of the testing should include the extent to which consumers accurately comprehend the disclosure and can utilise it appropriately to compare products and make decisions.

3. Need for cost / benefit analysis

It is important to bear in mind that this consideration of fees and costs is in the context of ensuring that what is disclosed to members in Product Disclosure Statements (PDS) and in periodic statements is meaningful and useful.

While it is imperative that the regime be assessed through the lens of consumer disclosure, it is also important that it strives to ensure that it does not necessitate funds incurring unnecessary additional costs - the costs of complying should be balanced against, and commensurate with, any benefits which are delivered to consumers.

4. Application of regime to variety of investment arrangements and structures

The variety and complexity of the different arrangement and structures through which investments are made creates a number of difficulties in designing an appropriate regime.

It is important to mitigate the risk of inconsistent results for consumers and unnecessary costs being incurred by trustees, and to ensure that the regime is as neutral as to arrangement/nature/structure/type of investment/asset as possible.

5. Alignment with managed investment scheme disclosure

ASFA supports alignment of managed investment schemes disclosure regime with the regime pertaining to superannuation fund disclosure, to the extent possible.

This is important to ensure consistency of disclosure to consumers and to minimise the risk of confusion, especially where consumers invest in what is essentially the same fund provided by the same product issuer, and to remove unnecessary difficulties and additional expense for trustees in identifying, capturing, storing, deriving and disclosing information.

6. Materiality

ASFA supports considering the introduction of materiality where it may be appropriate to do so.

In some instances, incorporating a concept of materiality may be a suitable mechanism by which to strike a reasonable balance between disclosure to members and cost to funds. It is important, however, that any consideration of materiality must take place in the context of the holistic outcome and considerations of materiality will need to be balanced against the objective of meaningful disclosure.

Spurious precision for the sake of technical accuracy, where the outcome will have little bearing on members, should not be required. On the other hand, care should be taken with any argument that individual line items that are not material make a minimal contribution and so can be disregarded – a number of small amounts can add up to a significant amount and can have a material effect on the overall disclosure outcome.

It would appear that the key to this aspect may be striking the right level of disaggregation / aggregation of costs to be disclosed.

7. Timeframe to implement changes

ASFA members have indicated that, in light of all of the changes proposed in CP 308, a reasonable timeframe to implement these changes would be a minimum of 18 months following the finalisation of the requirements, including the revised Schedule 10 to the Corporations regulations and the updated RG 97. The effect date for implementation should provide a reasonable transition period, take into account financial year end and enable the scheduling of PDS rolls.

8. Protecting Your Super

Paragraph 40 of CP 308 states that

40. While the PYSP Bill had not be passed at the time this consultation paper was published, we believe that, if passed, the PYSP Bill (and any associated regulations) may have significant impacts on the proposals set out in this paper. In particular, it may not be possible to implement:

(a) recommendation 11 (see proposal B1), as the merger of indirect costs with administration fees and investment fees will result in indirect costs no longer being a stand-alone visible figure in superannuation product PDSs; and

(b) recommendation 16 (see proposal B4), which proposes to simplify periodic statements to no longer show indirect costs as a stand-alone visible figure.

41 Accordingly, we may need to reconsider the proposals in this paper if Parliament passes the PYSP Bill and/or any associated regulations are made. This may occur during the consultation period or following consultation and implementation of the proposals in this paper.

The recent passing of the Protecting Your Super Package (PYS) legislation has served to create uncertainty in relation to the proposals in CP 308.

As ASIC has indicated above, it may not be possible to implement some of the proposals, as currently described, as a result of the passage of the PYS legislation - in particular the fee cap measure. ASFA member funds have indicated that some of the proposals regarding fee and costs disclosure in PDSs and periodic statements may need to be reassessed and welcome the opportunity to provide further feedback on any amended proposals.

9. Consultation Paper 308, draft amendments to Schedule 10 and draft updated Regulatory Guide 97

We have provided specific feedback and comments on Consultation Paper 308, the draft amendments to Schedule 10 and the draft updated Regulatory Guide 97 below.

Specific comments

Consultation Paper 308

1. **B4Q9 - Periodic statement must show two transactions— one for full amount charged and one for tax benefit passed on to member (Page 28)**
B4Q12 - 'Total fees and costs you paid' presented gross of any tax benefit passed on to the member (Page 28)

CP 308 states at B4Q9 that

We have retained the guidance that appears in the current version of RG 97 (at RG 97.237) that if the payment of a fee or cost results in the superannuation entity or registered scheme becoming entitled to a tax deduction, and the benefit is passed on to a member, the periodic statement must show two transactions—being one for the full amount charged and one for the tax benefit that was passed on to the member: see draft updated RG 97 at RG 97.126 and RG 97.234 at Attachment 1 to this paper. Should this guidance be retained? Please explain why or why not.

CP 308 states at B4Q10 that

Should 'Total fees and costs you paid' in cl 302(1) of Sch 10 be presented gross of any tax benefit passed on to the member: see RG 97 at RG 97.237? Please explain why or why not?

ASFA member funds generally support the disclosure in periodic statements either of

- the net administration fee charged; or
- the gross administration fee charged and any rebate passed on to members.

Members funds are divided, however, on the need to disclose – as part of 'Total fees and costs you paid' - 'grossed-up' administration fees. While some member funds agree with the concept of 'grossing up' the administration fee, other member funds are concerned that the artificial 'grossing - up' of the administration fee is confusing, and potentially misleading, to consumers.

Some member funds consider that the important, and meaningful, information from a consumer's perspective is the amount of administration fees that they have paid, directly or indirectly, during a member reporting period. There is an argument that the underlying costs of operating the fund, and the extent to which the fund has received a tax deduction for those costs, are not relevant to the consumer - what is relevant is the administration fee which the consumer actually has paid.

Most member funds agree that it is desirable for the administration fees disclosed in the PDS to align with the transactions in the member's periodic statement (i.e. what members actually pay). While most funds feel this approach makes the most sense for the consumer, there is also the need for PDSs to facilitate comparability between products.

For funds which make allowance for the expected amount of the tax deduction prior to determining the administration fee to be charged (net admin fee), the interpretation of the current requirement is that the administration fees must be disclosed on a 'gross of tax' basis. It is unclear as to whether this requirement has arisen as an extension to the requirement to disclose GST and stamp duty, and / or to facilitate comparability with products which charge a 'gross' administration fee and then provide a rebate to the member.

With respect to GST and stamp duty, the current version of RG 97 states at RG 97.171

*RG 97.171 An issuer of a superannuation product must disclose fees and costs information in their PDS in accordance with Schs 10 and 10D. Clause 204(7) of Sch 10 requires a cost or amount paid or payable to include, if applicable, **GST** (less any reduced input tax credits) and **stamp duty** (emphasis added).*

This makes perfect sense:

- GST, if payable (which it isn't with respect to administration fees), would be an additional amount payable directly by the consumer and, consistent with the rest of the GST regime, should be disclosed
- Stamp duty, if payable (which it isn't with respect to administration fees), similarly would represent an amount directly payable by the consumer and should be disclosed.

Some member funds consider, in the context of administration fees, that the extension to disclosure on a 'gross of income tax' basis - taking into account the tax deduction for costs which may be claimed - is misconceived.

A superannuation product

- incurs expenses and other costs (**gross costs**)
- is able to claim a deduction with respect the payment of (most) costs (**deduction**). This could include a 'fee' payable to a third party, but in this context this amount properly is characterised as a **cost** to the product and should not be confused with, nor include, a fee charged by the product provider to the member
- is left with a residual amount of costs which is to be recovered by the charging of administration fees (**net costs**)
- having regard to the amount of net costs and the underlying demographics of the membership of the product, determines an amount to be charged to members, through deducting it from their account, to cover those costs (**administration fee**). The administration **fee** may generate a total amount which exceeds, is equal to or is less than the total amount of net **costs**.

What is relevant to consumers is the **net amount of the administration fee deducted**. What is not relevant to the consumer is the concept of an income tax deduction the trustee may have been able to claim with respect to the underlying **costs** - not with respect to the administration **fee**.

With respect to facilitating comparability in PDSs between those products that charge a 'net' administration fee and those that charge a 'gross' administration fee and provide a rebate, there are divergent views as to how best to achieve this. While 'grossing up' the net administration fee is one approach, an alternative may be that products that charge a 'gross' administration fee and provide a rebate could disclose the amount of the fee and the expected range of possible rebates, from which the likely net fee could be determined.

Member funds have indicated that more work will need to be done with respect to how administration fees should be disclosed to consumers in PDSs. ASFA and its members funds would be happy to work with ASIC on this aspect of fee and cost disclosure.

What should be disclosed to consumers in their periodic statement is the amount of the administration fee paid by the member.

In circumstances where a gross administration fee is levied, and a tax rebate paid to the member separately, two transactions should be disclosed.

More work will need to be done with respect to how administration fees should be disclosed to consumers in Product Disclosure Statements.

2. B6 – Removing property operating costs, borrowing costs and implicit transaction costs (Proposal: Recommendation 24 in Report 581 – Page 32)

ASFA member funds strongly support the removal of property operating costs, borrowing costs and implicit transaction costs from the PDS and periodic statement disclosure.

For member funds that invest in real property, either directly or via an unlisted vehicle, property operating costs is a key issue and we are pleased that it has been determined that there is not a need to disclose these costs to consumers.

Member funds have highlighted that inconsistencies in approach between listed and unlisted property investment remain, although the magnitude of the difference has been significantly alleviated through the exclusion of property operating costs.

ASFA member funds strongly support the removal of property operating costs, borrowing costs and implicit transaction costs from the PDS and periodic statement disclosure.

3. B7 – Inclusion of counterparty spreads – inclusion in transaction costs (Proposal: Recommendation 24 in Report 581 – Page 34)

ASFA members generally

- support the disclosure of explicit buy/sell spreads
- agree that market impact costs should not need to be disclosed.

When it comes to counterparty spreads, however, the position is less clear and will depend on how the concept of counterparty spreads is defined.

Further clarity is needed as to the definition of counterparty spreads - it should be defined carefully before consideration is given to whether or not such amounts need to be disclosed.

Some ASFA member funds do not support the inclusion of counterparty spreads in transaction costs with respect to Over The Counter (OTC) markets. As OTC markets do not have a central exchange, there is no agreed bid and offer price. Instead the OTC market is dependent on the individual counterparties making a market in the security and, as a result, bid and offer prices can and do vary widely between counterparties for the same security.

Further clarity is needed as to definition of counterparty spreads - it should be defined carefully before consideration is given to whether or not such amounts need to be disclosed.

If it is decided that OTC counterparty spreads are to be included in transaction costs, it is important to note that most superannuation funds do not collect data on the bid-ask spread.

If it is decided that counterparty spreads need to be disclosed, consideration will need to be given as to whether estimates can be used. It is important to recognise that this extends to most derivatives and options (other than bespoke derivatives), bonds and FX spot transactions.

4. B11 – Clarifying the treatment of costs paid out of reserves (Proposal: Recommendation 30 in Report 581 - Page 40)

Member funds do not agree with the proposed changes to administration fees and investment fees with respect to amounts paid out of reserves since:

- with respect to administration fees - what is relevant is the amount members will be charged if they join the fund; and
- with respect to investment fees - what is relevant is amounts that have reduced returns to members in a particular year.

In neither case does this extend to amounts paid out of reserves, and some member funds have expressed concern that there appears to be duplication with respect to the treatment of reserves, as fees charged to members are credited to reserves and the operating costs of the product are debited from reserves.

Funds must consider member equity, including intergenerational equity, when recovering costs which are more in the nature of capital expenditure, including those associated with product development, technology uplift and legislative changes. Reserves are used to align the timing of the recovery of costs to when members actually receive the benefit from those costs.

By way of example provided by a member fund, a significant legislative change may require a large cost to implement in a particular year, however, the benefits realised by members may be realised some time into the future. Accordingly, the manner in which a product may recover costs will not necessarily match the timing of the expense, as the timing of the incurring of the expense and the recovery are independent.

A further consideration is how a reserve is funded initially and maintained at a level deemed appropriate. Should a product determine to fund, or 'top-up', a particular reserve (e.g. the Operational Risk Financial Requirement or ORFR) through moving funds from another reserve, this should not be considered to be a fee to the member. The member has already paid the administration fee which has gone into the reserve – they are not being levied an additional amount – and so to consider the amount being transferred between reserves as an administration fee would amount to double-counting.

It has been suggested that reserves should be treated in the same manner as retained earnings in an ordinary company. This means that, if the Trustee determines that the product should maintain a particular level of capital reserve to reinvest in providing better services, products or technology to members, it should be able to do so without it being considered to be a fee or cost. It effectively is a decision with respect to the management of capital and should be treated as such.

It is important to note that this is in the context of disclosure to consumers. Movements in reserves, and the funds reserving strategy, already are required to be disclosed to members in a fund's annual report. Any considerations as to the viability of a funds' fee structure are for APRA, as the prudential regulator, and are not relevant to consumer disclosure.

Only amounts charged to members should be disclosed – it is not relevant to disclose amounts paid into, or out of, reserves.

5. E2 – Treatment of derivative financial products (Page 67)

The treatment of OTC derivative costs remains inconsistent between Managed Investment Schemes (MIS) and superannuation, for example hedging costs.

Alignment between fees and costs for a managed investment product disclosed in management costs, and fees and costs for a superannuation product disclosed under investment and administration fees and costs is critical for consumers as disclosure is less complex and aligned – if there is alignment then platform members can rely solely on the underlying managed fund disclosure. It would also allow superannuation platform providers to be able to avoid having to seek additional information from fund managers to calculate 'superannuation equivalent' costs.

With this in mind, some ASFA members have recommended that the treatment of OTC costs should be aligned and that superannuation products disclose OTC transaction costs on the same basis as the current treatment for managed investment products i.e. under transaction costs in the 'Fee summary template'.

We believe this alignment is best achieved by amending clause 101A(4) so that this clause also applies to superannuation products and would ensure that any transactional costs are appropriately disclosed under 'Transaction costs' in the 'Fees and costs summary'.

The treatment of OTC costs should be aligned and that superannuation products disclose OTC transaction costs on the same basis as the current treatment for managed investment products i.e. under transaction costs in the 'Fee summary template'.

6. Cost of product

Some ASFA member funds have acknowledged that disclosing the cost of product for each choice investment option would assist to some degree with the comparability of investment options but note, however, that each member's experience would be different depending on the fees levied at account level and the member's account balances. They believe that the format of the disclosure should not be prescribed and have suggested that this information could be presented as an additional column in choice investment option fee and cost disclosure tables, which are either incorporated by reference or disclosed in the 'Fees and costs details' section of the PDS.

Further they consider that, when arriving at the annual cost of product example for superannuation, the need to incorporate a contribution of \$5,000 is confusing to consumers and will not change the outcome in MySuper products as contribution fees are not permitted. Similarly, for a superannuation product in pension phase where contributions are not permitted to be made, this could be a source of confusion for consumers.

Accordingly they have suggested that the disclosure requirements for superannuation and managed investment products should be aligned such that any applicable contribution fee should be included as a footnote, in keeping with the disclosure of buy/sell spreads and exit fees.

- Some members have suggested that
- the format of the total cost disclosure should not be prescribed – it could be presented as an additional column in choice investment option fee and cost disclosure tables
 - any applicable contribution fee should be included as a footnote, in keeping with the disclosure of buy/sell spreads and exit fees.

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