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Dear Maan,

RE: Draft Class Order [CO 14/xxxx] – Disclosure of fees for superannuation trustees and managed investment scheme responsible entities

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission regarding the draft Class Order [CO 14/xxxx] *Disclosure of fees for superannuation trustees and managed investment scheme responsible entities* (draft Class Order) and the accompanying paper: *Proposed Class order: Schedule 10 technical amendments* (Background Paper). These documents were provided to us via email on 24 September 2014, with a revised version of the draft Class Order provided to us via email on 9 October 2014. We appreciate the short extension of time allowed for us to provide our response.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 12 million Australians with superannuation.

Executive summary

ASFA strongly considers that amendments to the underlying legislation are necessary, in order to provide full clarity between the concepts of 'fees' and 'costs' for disclosure purposes. The necessary amendments are, in our view, too fundamental and extensive to be effected via Class Order modification alone. ASFA also considers that the requirement that a trustee 'look-through' to ascertain the indirect costs incurred within interposed vehicles should be limited to the first non-associated entity.

In terms of the amendments proposed in the draft Class Order, we consider it imperative that ASIC provides a reasonable transition period, and that the amendments should only apply to new Product Disclosure Statements issued from 1 July 2015. Feedback from ASFA members strongly indicates that a 'hard' 1 July 2015 commencement date for the proposed amendments will impose a substantial financial cost and compliance burden on industry.

1. General comments

We appreciate the efforts that ASIC is making to clarify the requirements regarding disclosure of fees and costs in Product Disclosure Statements (PDSs) through Class Order modification. However, as we have indicated to ASIC and Treasury in previous submissions and meetings, we consider it critical that the disclosure requirements in the *Corporations Regulations 2001* (Corporations Regulations) are themselves revisited as a matter of urgency.

In particular, there is, in ASFA's view, an urgent need to:

1. Provide clarity around what is a 'fee' as opposed to a 'cost', ensuring that industry is provided with clear definitions and guidelines around the intended definition of each for disclosure purposes.

   We note the terms 'fee' and 'cost' are not defined in the relevant regulatory provisions. ASIC's existing guidance is example based rather than definitional and not, in our view, wholly consistent. In our view, definitions of 'direct' and 'indirect' would also greatly assist trustees' understanding of, and compliance with, the disclosure requirements.

2. Reconsider whether the prescribed disclosures (both current and proposed) in relation to indirect costs are meaningful to members.

   Whilst we acknowledge that comparability is a key objective of the PDS disclosure requirements, we question the extent to which concepts such as 'indirect cost' and 'indirect cost ratio' (ICR) provide any value for consumers or whether they, in fact, cause greater confusion. In particular, we submit that, while there is validity to disclosing indirect costs with respect to the fund\managed investment, we dispute there is any value in looking through to underlying investments.

A number of ASFA members have questioned whether looking through beyond the first non-associated entity provides any material benefit to consumers.

The Corporations Regulations were amended in 2005 to require 'dollar disclosure' of transactions, fees and costs. The Explanatory Statement to the amending regulations, the *Corporations Amendment Regulations 2005 (No. 1)*, stated as follows:

> *where an investor invests in a superannuation fund or managed investment product which itself has made an investment through a trust or other structure which holds the underlying investment assets, the costs of investing through the interposed entity must be captured as they are not costs which an investor would necessarily incur if they invested directly in the underlying investment assets. This ensures that layers of 'management costs' are captured where there are (sic) a chain of entities involved.*
>
> *In defining 'management costs' in this way, 'management costs' only comprise the additional fees or costs that a member or product holder incurs by investing in a superannuation fund or managed investment product rather than investing directly in the underlying assets.*

When a consumer is comparing between two or more different products the two key factors to be compared directly affect the expected performance of their account. These are:

- the historical and expected rates of net return credited to their account; and
- the quantum of fees and charges levied or deducted directly from their contributions; roll-overs; accounts or benefits paid ('direct fees').

There appears to be considerable confusion, and blurring of the line, between:

- the costs incurred in the running of the fund ('fund costs'); and
- their recovery through:
    - direct fees levied on the member; or
    - indirect costs, or possibly indirect fees, deducted from the gross return prior to determining the net return to be credited ('indirect costs').

It is the quantum, and timing, of the:

- direct fees levied; and
- net earnings credited after indirect costs have been deducted ('net earnings')

which will determine the value of the member's final benefit.

A trustee has a certain quantum of fund costs which it needs to recover. It can only do this in one of two ways, through:

- direct fees levied on members; or
- indirect costs deducted from returns.

The two extremes would be to recover all fund costs through:

- direct fees, which would see the net return credited to member accounts being the same as the gross return earned, as there would be no indirect costs to be deducted; and
- indirect costs, which would see no direct fees levied and the net return credited to member accounts reduced by an amount of indirect costs which would be equivalent to the amount of fund costs.

Most trustees effect a combination of direct fees and indirect costs to varying degrees, somewhere between these two extremes.

Accordingly, indirect costs which are incurred *within the entity itself* are clearly relevant – these are controlled by the trustee and have a direct effect on the net return credits to a member's benefit. As such they must be disclosed.

When it comes to interposed entities, however, it is much less apparent why it is considered that the costs of investing through those entities must be captured and disclosed as an indirect cost.

These costs will be recovered by the interposed entity either through

- charging a direct fee to the superannuation fund trustee (which will form part of fund costs) which will in turn be recovered by the trustee either through a direct fee levied on the member and\or via an indirect cost deducted from returns; or
- a reduction in the return paid from that investment.

There is an automatic mechanism whereby the costs of these underlying entities are reflected – either in a fee charged to the trustee and passed on to the member and/or in reduced returns received from the entity. Not only is it not meaningful to identify and disclose separately the indirect costs of interposed entities, given that any indirect costs of the interposed entity will be reflected in reduced returns there is a risk of 'double-counting'.

As such, we submit that disclosure of an interposed entities indirect costs is irrelevant and potentially misleading. The one exception to this is where the interposed entity is associated with the fund trustee. In this case, costs can be shifted between the trustee and the interposed entity and, accordingly, the indirect costs of the interposed entity should be disclosed as well.

While the argument for disclosing the costs of the interposed entity is that it would reveal costs which an investor would not necessarily incur if they invested directly in the underlying investment assets, these costs will in any event be reflected in higher direct fees and\or lower net returns.

Further, as noted above the Explanatory Statement to the *Corporations Amendment Regulations 2005 (No. 1)* indicated that the costs to be disclosed should "only comprise the *additional* fees or costs that a member or product holder incurs by investing in a superannuation fund or managed investment product rather than investing directly in the underlying assets". Given that the indirect costs of the trustee or interposed entity may include costs which the member would have incurred had they invested directly in the underlying asset (for example, brokerage costs may not be charged to the member but form part of indirect costs) there is no guarantee that the indirect costs are confined to 'additional' costs.

Accordingly, ASFA submits that look-through should apply only to the first non-associated entity.

We acknowledge that the amendments necessary to comprehensively address these issues would be substantial, and as such it may not be possible – or appropriate – to give effect to them via Class Order modification. However, we are concerned that further piecemeal modifications may lead to an incomplete, inconsistent and sub-optimal resolution of the issues industry has raised in relation to the fee and cost disclosure requirements. We would welcome the opportunity to discuss these matters with ASIC and Treasury.

2. Responses to specific consultation questions raised in the background paper

As requested, we provide below our feedback on the specific consultations questions raised in the Background Paper which accompanied the draft Class Order.

All legislative references below are to clauses contained in Schedule 10 of the *Corporations Regulations 2001* (Schedule 10) or sections of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

2.1 Section B - Proposed technical amendments to Schedule 10 to the Corporations Regulations

2.1.1 Indirect cost, double counting and switching fee

B1Q1 Do you agree with the provision that a trustee may reasonably estimate indirect costs when these costs are not known? If not, how do you propose that indirect costs of an investment be disclosed when these costs are not known?

The draft Class Order proposes inserting the words "a trustee knows or reasonably ought to know **or, where this is not the case, may reasonably estimate**" (our emphasis) into the definition of 'indirect costs'. We note that, as well as determining the calculation of 'indirect costs', this definition will also impact on the ICR which is, pursuant to clause 209A, derived using those costs.

As per our comments above, ASFA submits that look-through should apply only to the first non-associated entity. A trustee should always know the past indirect costs with respect to the fund and any associated entities, as well as be in a position to estimate future costs.

The extension of indirect costs beyond associated entities gives rise to issues where trustees do not know, or have a basis on which to reasonably estimate, indirect costs. While ASFA agrees *in principle* that trustees should be required to reasonably estimate indirect costs when these costs are not known, we are concerned that there is a lack of clarity around how such estimates are to be determined. In particular, we note the following:

1. The inserted wording introduces an additional layer of subjectivity, such that 'indirect costs' (and therefore the ICR) will be calculated differently depending on the circumstances of each fund and on the judgements made by trustees. As a result, there will be little comparability between the indirect cost figures calculated and disclosed by different trustees.

2. It is not clear how a trustee could be expected to reasonably estimate an indirect cost if it does not have any information on which to base such an estimate, despite having taken reasonable steps to obtain it. In the absence of confirmed data, trustees will, as a matter of practice, need to apply either a:

   - backward looking approach, using historical/prior year costs; or
   - forward looking approach, using a combination of known and estimated future costs.

   In ASFA's view, there needs to be a clear statement in the regulatory provisions themselves (or at a minimum in some accompanying guidance material) regarding the approach to be adopted. Failure to provide such clarity will not achieve consistency across the industry. We note that, while ASIC has expressed a preference for forward looking estimation of costs (for example, in relation to performance fees), industry practice currently tends more towards the use of historical data.

3. The 'reasonableness' of any estimate is likely to be affected by circumstances such as the duration of the trustee's investment in the interposed vehicle. For example, it is questionable whether a trustee will be in a position to reasonably estimate costs where it has invested in an interposed vehicle for only a short time.

4. The draft Class Order does not specifically require a trustee to disclose where they have used a 'reasonable estimate' in calculating indirect costs. This will serve to further reduce the transparency and comparability of the indirect cost disclosures between funds.

   We note that existing sub-clauses 204(4) and (5) of Schedule 10 oblige a trustee, when completing the fees and costs template required by clause 201, to provide a reasonable estimate of the amount if the exact amount of a cost is not known. Importantly, those provisions also require the trustee to clearly designate where an estimate has been used. However, this requirement is limited to the completion of the fees and costs template and does not apply to other aspects of PDS disclosure, such as the example of annual fees and costs.

   Rather than incorporating the concept of 'reasonable estimates' into the definition of 'indirect costs', we recommend that ASIC considers relocating the principles set out in sub-clauses 204(4) and (5) into Part 1 of Schedule 10, thereby expanding their application to all aspects of PDS disclosure, and provide appropriate guidance to trustees on how the principles are to be applied.

> We consider it important that estimated amounts are clearly designated as such, and on current drafting the proposed modification will not achieve that aim. While we acknowledge that it may be difficult to make an amendment of this nature via Class Order modification, we reiterate our earlier recommendation that the drafting of the underlying regulations be reviewed and addressed as a matter of urgency.

Given the extent of the concerns raised by industry in relation to the fee and cost disclosure rules since they were first released in draft in April 2013, it is critical that any amendments made now are clear and accompanied by appropriate guidance to trustees. Accordingly, if ASIC proceeds with the proposed modification to introduce a 'reasonable estimation' concept into the 'indirect cost' definition, we recommend that clear guidance is provided to trustees on what ASIC considers to be the basis for a 'reasonable' estimate, so as to minimise potential inconsistencies in funds' disclosure of indirect costs. Ideally, this guidance should include examples.

B1Q2

Does the amended indirect costs definition address any instances of double counting of fees?

While the proposed amendment makes it clear that double counting of fees is not intended, its wording still evinces, in our view, a confusion between a fee that is charged to a member and a cost that may be recouped (in whole or part) via the charging of such a fee. Both the current (unmodified) and proposed new definitions of 'indirect cost' refer to an amount that is not 'charged' to a member as a fee.

There are three possible scenarios by which a trustee could decide to recover a particular cost (for example, an investment cost):

	Mechanism	**Disclosed in PDS**	**Disclosed in periodic statement**
1	Direct fee levied against:		
	• contribution	Yes	Depends whether deducted before/after credited to account
	• roll-over in	Yes	Depends whether deducted before/after credited to account
	• account	Yes	Yes
	• benefit paid	Yes	Yes
2	Fee deducted from unit price/crediting rate	Yes	No
3	No explicit fee per se - indirect cost deducted from unit price/crediting rate	No	No

With respect to the scenarios above:

1. Clearly an amount is being 'charged' to the member, although if it is with respect to contributions or roll-overs in and is being deducted prior to allocation to the member's account it will not be apparent in the member's periodic statement. As such this amount will *not* form part of 'indirect costs'.

2. While a fee has been disclosed in the PDS, the quantum is not readily apparent to the member as it will not be disclosed in their periodic statement. On the one hand there is a fee which has been disclosed in the PDS, however, as it is being deducted from the unit price or crediting rate, it is unclear whether it is being 'charged to the member'. Accordingly, it is unclear as to whether or not this would form part of 'indirect costs'.

3. As there is no fee disclosed in the PDS and the amount is deducted from the unit price (or crediting rate) clearly this amount *will* form part of 'indirect costs'.

Accordingly, there is a need to resolve the appropriate treatment with respect to scenario 2:

- on the one hand - given that it not charged to the member directly but is deducted from the unit price (or crediting rate) - it could be considered to be an indirect cost and treated in an identical fashion to scenario 3, notwithstanding that it has been disclosed as a fee in the PDS.
- on the other hand – given that a fee has been disclosed in the PDS, then notwithstanding the fact that it is deducted from the unit price (or crediting rate) it could be regarded as a fee and not an indirect cost.

Once clarity has been reached regarding the desired policy outcome, we recommend the following actions:

(i) in the short term - the Class Order could remove the nexus between Schedule 10 and the fee definitions in section 29V, and insert specific definitions for disclosure purposes which do not already incorporate indirect costs. This would allow the fee template and example of annual fees and costs to provide meaningful disclosure of indirect costs, separately from the defined fee types for the product/fund. It would also remove an element of potential confusion in relation to choice products, caused by the cross-reference to section 29V, which relates to the fees that may be charged in a MySuper product.

(ii) in the longer term, the definitions of 'administration fee' and 'investment fee' in section 29V of the SIS Act could be amended to remove the reference to indirect costs. By way of example, the definition of 'investment fee' could be amended to make it clear that:

    a) investment fees are fees which are charged *directly* against the member; while

    b) investment costs are not recovered through investment fees charged directly against the member, but instead reduce the return on investment credited to members, are to be categorised and disclosed as part of the 'indirect costs' for the product.

In conjunction with this, we recommend that ASIC provides detailed guidance:

(i) in the short term via Frequently Asked Questions; and

(ii) in the longer term, in Regulatory Guide 97: *Disclosing fees and costs in PDSs and periodic statements*, when that Guide is updated.

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B1Q3
Does the definition of switching fee result in instances of double counting of a fee where a switch from one product to another within a superannuation entity may be captured by another fee?

The proposed definition of 'switching fee' is, in our view, an improvement on the current (unmodified) definition. However, some ASFA members have raised concerns that there may still be some potential for double counting or overlapping of fees and costs in relation to a switch from one product to another within the superannuation entity, for example due to the way the switching fee interacts with the buy-sell spread and with exit fees.

To avoid any such risk of double counting, we recommend that the proposed definition of 'switching fee' be further amended to expressly exclude any parts of the fee or cost that are caught by one of the other prescribed fee definitions in section 29V of the SIS Act.

B1Q4
Are there any unanticipated consequences from these amendments?

'Interposed vehicle'

As per our comments in section 1 above, ASFA submits that look-through should apply only to the first non-associated entity.

As a threshold matter, we note that many of the difficulties associated with identifying ultimate underlying assets and the costs of interposed vehicles are similar to concerns raised by the industry in relation to portfolio holdings disclosure, which has been deferred pending further consultation. In ASFA's view, the difficulties associated with identifying and disclosing indirect costs warrant the same level of consideration and analysis, to ensure the burden on trustees is balanced with the perceived benefits that would arise from greater transparency.

Further, the extent of the look-through raises a number of practical and legal considerations:

1. Requiring trustees to look-through to the last interposed vehicle raises a number of concerns. In particular, it significantly exceeds the requirement that applies for APRA data reporting purposes, which involves look-through into the first non-associated entity. In many cases it will be impractical (if not impossible) to expect trustees to identify all interposed vehicles and their associated costs. In particular, it should be noted that:
   - the arrangement under which superannuation fund assets are invested is based on either contract or trust. A trustee typically has a legal relationship only with its direct counterparty, and not with counterparties further down an investment chain.
   - further, trustees may have little or no scope to force its counterparty, or those down the chain, to provide the relevant information about indirect costs (because the relationships are based on negotiations or existing arrangements, for example where a trustee 'buys into' an existing investment trust). There are also existing long term contractual/trust relationships in place, and in practice it may not be possible to amend these, to facilitate the trustee's compliance with changes to disclosure requirements, in the short to medium term.

- in some cases, interposed entities may be unwilling to provide information on underlying assets and\or their costs due to their desire to keep such information confidential for commercial reasons. This is particularly the case with respect to those located overseas. We note that, unlike the portfolio holdings disclosure requirements, there is no corresponding requirement on these interposed parties to provide the information to trustees to facilitate calculation and disclosure of indirect costs for PDS purposes.

2. The differing levels of look-through required by Schedule 10 (both currently and under the proposed modification), as compared to the APRA data reporting standards, will be problematic for trustees once section 29QC of the SIS Act resumes operation from 1 July 2015. Section 29QC essentially requires trustee disclosures to be consistent with information reported to APRA. In particular, we note that the instructions to SRF 702.0 Investment Performance indicate as follows:

   For the purposes of these instructions, 'look-through basis' means the reporting of information about the underlying investment in an investment vehicle. This is for the purposes of identifying fees and costs that relate to connected service providers that are not directly engaged by the RSE licensee but are engaged by other service providers and involves looking through cascading entities to the first non-connected entity.

   This concept of look-through, and the costs to be identified, is at odds with the definitions of 'interposed vehicle' and 'indirect costs' as contained in the draft Class Order.

3. In addition to these legal and practical difficulties, the requirement to identify all interposed vehicles and their costs will impose a significant cost and resource burden on trustees.

ASFA recommends that ASIC considers adopting an alternate approach, which achieves an appropriate balance between transparency and comparability on the one hand, and cost and compliance burden on the other. For example:

- the regulations could retain a requirement to calculate and disclose indirect costs, but require trustees to look-through associated entities only, with no obligation to look-through non-associated entities. This would be consistent with APRA's approach in data reporting standards such as SRS 532.0 and, since much of the data is already being collected for reporting purposes, it would significantly reduce the burden on trustees. It would also ensure consistency of disclosure between funds and reduce the likelihood of trustees 'hiding' costs by moving them to associated entities where they become 'indirect costs'.
- alternatively, the regulations could limit the look-through in another way. For example, some APRA data reporting standards take the approach that hedge funds are an 'asset class' rather than an investment vehicle, with the effect that trustees are not required to report on the underlying assets of hedge funds. This type of approach could also be adopted in relation to indirect costs to provide some certainty for trustees and to remove some of the practical difficulties in complying with the requirements.

In relation to the amendments proposed in the draft Class Order, our specific concerns are as follows:

- in ASFA's view, the definition of 'interposed vehicle' contained in the version of the draft Class Order provided to industry on 24 September 2014 was extremely unclear. The proposed definition was phrased in a manner which was extremely convoluted and difficult to follow, raising genuine concerns about whether it would be consistently interpreted and applied across the industry.

- the amendments made in the revised version of the draft Class Order provided to industry on 9 October 2014 have significantly improved the readability of the definition and, we consider, have reduced the risk of misinterpretation and inconsistent application.
- we note, however, that a number of ASFA members have queried the intent of subparagraph (c)(ii), which appears in both the original and revised versions of the definition. In particular, it is unclear in what circumstances a body, trust or partnership would *not* reasonably be regarded as the means by which people holding an interest would obtain a financial return or benefit.

2.1.4 Interposed vehicles in managed investment schemes

B2Q1 Do you agree with the provision that a responsible entity may reasonably estimate indirect costs when these costs are not known? If not, how do you propose that indirect costs of an investment be disclosed when these costs are not known?

It is, in ASFA's view, important there is consistency between the definitions of 'indirect cost' for superannuation products and managed investment products. The application of different requirements to superannuation and managed investment products is problematic, especially where members invest in managed funds through superannuation platforms.

Please refer to our response to consultation question B1Q1 above, where we outlined our concerns regarding the lack of clarity as to how the estimation process should be undertaken.

B2Q2 Are there any unanticipated consequences from these amendments?

ASFA members have not raised any unanticipated consequences from these amendments.

2.1.5 Defined fees and switching fees

ASFA supports the amendment to clause 209A to expressly permit incorporation of the prescribed fee definitions into the PDS by reference.

As well as responding to the specific consultation questions B3Q1 and B3Q2 immediately below, we have outlined at section 3.2 of this submission a number of additional comments in relation to the wording of the prescribed fee definitions.

B3Q1 Does the definition of switching fee result in instances of double counting of a fee where a switch from one product to another within a superannuation entity may be captured by another fee?

Please refer to our comments in relation to consultation question B1Q3 above.

B3Q2 Are there any unanticipated consequences from these amendments?

ASFA members have not raised any unanticipated consequences from these amendments.

2.1.6 Consumer advisory warning

B4Q1 Do the amended consumer advisory warnings more accurately reflect the appropriate terminology for superannuation and managed investment products, and reduce confusion for members?

ASFA considers that the separation of the consumer advisory warnings for superannuation and managed investment products is appropriate and likely to reduce confusion for readers of the PDS.

The proposed terminology for the consumer awareness warning for superannuation products is, in our view, generally appropriate for some standard employer sponsored, accumulation style superannuation products. However, both the current and proposed versions of the consumer advisory warning contain this prescribed statement:

> *Your employer may be able to negotiate to pay lower administration fees. Ask the fund or your financial adviser.*

ASFA considers it inappropriate for the warning to direct a member to ask the fund or their financial adviser about whether *their employer* is able to negotiate lower administration fees. Such a direction is in our view only appropriate where *the member themselves* is able to negotiate lower administration fees.

In addition, application of the proposed consumer advisory warning to other types of superannuation products remains problematic – refer to our comments below in relation to consultation questions B4Q2.

B4Q2 Are there any other products which would benefit from amended terminology (eg the removal of references to 'employer')?

We have outlined above, in response to consultation question B4Q1, further amendments which we consider necessary to ensure that the proposed superannuation specific consumer advisory warning is appropriate for employer-sponsored superannuation products.

We note that the prescribed statement regarding the potential ability of an employer to negotiate to pay lower administration fees is also inappropriate for superannuation products which do not involve any standard employer sponsored component – including 'personal' superannuation products and superannuation income streams (pensions) – and for products where there is no ability to negotiate lower fees.

ASFA recommends that trustees be permitted, *where relevant*, to:

- replace the phrase "Your employer may be able to negotiate to pay lower administration fees" with "You may be able to negotiate to pay lower administration fees";
- refer to an ability to negotiate a reduction in other types of fees (not simply administration fees); and
- omit any reference to negotiating lower fees (or negotiating lower fees of a particular type) if this is not a feature of the product.

This would obviate the current need for many superannuation fund PDSs (or incorporated by reference material) to explain that the prescribed wording is not applicable to the product, and would minimise potential confusion.

B4Q3 Are there any unanticipated consequences from these amendments?

ASFA members have not raised any unanticipated consequences from these amendments.

2.1.7 Consumer advisory warning placement

B5Q1 Is the exclusion of certain products from the requirement to publish a consumer advisory warning appropriate, and are there any further products that would benefit from this exclusion which are not presently covered?

The draft Class Order proposes an exemption from the requirement to publish a consumer advisory warning for certain types of managed investment products where fees or costs are not deducted from amounts held for members (declaration, item 7). This proposed exemption is, in ASFA's view, appropriate.

ASFA considers that an exemption from the requirement to publish the consumer advisory warning should apply in relation to defined benefit products (including defined benefit pensions) which do not have an accumulation component. In our view the warning is not relevant as the member's ultimate benefit from such products is predetermined and thus not impacted by the 'differences' in investment performance and fees and costs referred to in the prescribed consumer advisory warning.

B5Q2 Are there any unanticipated consequences from these amendments?

ASFA members have not raised any unanticipated consequences from these amendments.

2.2 Section C - Transition period

The proposed Class Order is intended to commence on the date it is registered under the *Legislative Instruments Act 2003*, and does not contain any transitional arrangements.

The Background Paper indicates ASIC's preference for a 'hard' commencement date for the modifications, "whereby all disclosure documents on issue at that time must comply with the amendments outlined in the Class Order". ASIC considers that a 'hard' commencement date of 1 July 2015 will "best achieve the desired outcome of consistent and comparable disclosure for consumers, while still providing industry with sufficient time to implement any required changes".

ASIC's media release 14-249 *ASIC seeks feedback to help clarify fee and cost disclosure requirements* describes the proposed amendments as merely "seeking to clarify" the disclosure requirements. In ASFA's view, this comment understates the extent of the proposed modifications and does not reflect the significant impacts the modifications will have on fund PDSs.

While we understand ASIC's desire to have a consistent 'cut-over date' for PDSs, we are concerned that achieving compliance by 1 July 2015 will be extremely onerous and costly for some trustees, and that a rushed implementation may not deliver the consistency that ASIC desires.

The need for appropriate transitional arrangements was raised with ASIC during an industry roundtable in August 2014 that was convened to discuss proposed amendments to the disclosure requirements. ASFA has previously recommended to ASIC that a transitional period of not less than 12 months should apply from the commencement of the modification.

In our view, this would provide trustees with an appropriate and reasonable timeframe to implement the modifications. The provision of measured transition arrangements would also avoid the significant compliance and cost burden which will arise if trustees are required to re-issue PDSs simply to comply with the law as modified by the Class Order. In this respect, we note the following:

- the re-issue of a PDS to comply with changed regulatory arrangements necessarily involves an extensive review process, generally including a review and sign-off by external legal advisers. Such a process is often significantly more time consuming than a PDS update driven by factors which are internal to the trustee (such as a change to product features). In our view, it is likely that the lack of clarity evident in the proposed definition of 'interposed vehicle' will increase the time needed by trustees and external legal advisers to complete the due diligence process supporting the reissue of the PDS. A rushed implementation period will, in our view, increase the likelihood of inconsistent application across the industry.
- most trustees have an established schedule or cycle for updating their product disclosure material. This is generally timed to avoid peak times such as 1 July in order to spread the demand on key business resources, and to align with internally driven events such as cyclical reviews of fees and costs, investment options, etc. A number of trustees have indicated that they update their PDSs in October to November each year. Similarly, many trustees with multiple products stagger the updating of PDSs for their various products throughout the year as to simultaneously update PDSs for all products would impose a significant load on resources, and involve a material increase in risk.
- with the consultation period for the draft Class Order closing mid-October, it is unlikely that the modifications will be finalised, and industry will have certainty on the disclosure requirements, much before the end of 2014. As a result, if a 1 July 2015 hard date were adopted trustees would have a constrained period within which to reissue PDSs for all products. This is likely to have a significant impact on trustee resourcing, potentially requiring an increased reliance on temporary or external staff (contractors), thereby increasing the level of business risk. It will also have a significant cost impact.
- ASFA sought an indication from our members of the likely cost to update and re-issue their PDSs for all products. Estimates from a number of trustees indicate that to update and re-issue PDSs (and incorporated by reference material) would generally cost in the order of $150,000 - $220,000 – however this assumes a level of control and flexibility over the timing of the update. To a large extent, these costs ultimately will be borne by superannuation fund members.

ASFA strongly recommends that transitional arrangements be included in the Class Order, such that:

- on the basis that the Class Order is finalised by 31 December 2014, new PDSs issued on or after 1 July 2015 are required to comply with the modifications; and
- all PDSs are required to be compliant within 12 months from commencement of the Class Order.

We also recommend that ASIC applies a facilitative compliance approach during the transition period.

3. Comments on matters not specifically raised in the background paper

We have outlined below a number of matters which were not specifically raised as consultation questions, but are in our view related to the content addressed in the draft Class Order. Please note that the matters below are not intended to represent an exhaustive list of all of industry's concerns in relation to the PDS and periodic statement disclosure provisions in the Corporations Regulations. We would welcome the opportunity to discuss issues with the disclosure provisions with ASIC and Treasury.

3.1 Clause 209A – prescribed wording re defined fees

ASFA supports the amendment to clause 209A to expressly permit incorporation of the prescribed fee definitions into the PDS by reference.

In ASFA's view, a number of other amendments to clause 209A should be considered in order to improve consumer engagement:

- trustees should not be required to include in their PDS (or incorporated by reference material) a definition for a prescribed fee type that is not relevant to the particular product. For example, insurance fees generally are not relevant to pension products and advice fees are not relevant to products where the trustee does not offer any form of advice.
- trustees should have the ability to tailor ('personalise') the wording rather than use generic wording which is confusing to members and at odds with the terminology adopted elsewhere in the PDS (or incorporated by reference material) and other disclosure material. For example, trustees should be permitted to replace 'superannuation entity' with either the name of the fund or the generic term 'the fund'.
- the proposed amendment to the definition of 'switching fee' that must be included (or incorporated by reference) in the PDS should not require trustees to specifically refer to "subsection 29V(5) of the SIS Act". Instead, we recommend that the definition be expanded to incorporate the wording from subsection 29V(5), without citing the legislative reference for the definition. Citing a legislative reference is of negligible use to a consumer and should only employed as a last resort if the regulatory provision is too extensive to summarise.
- the use of legalistic terms in the prescribed definitions that must be included (or incorporated by reference) in the PDS be avoided. In particular, the definition of 'switching fee' should not refer to a "class of beneficial interest", and the definition of 'insurance fee' should not refer to "realisation of a risk".

Trustees have indicated to ASFA that members find legislative references and legalistic terminology such as this to be opaque and confusing. The use of such language inhibits consumers' understanding of the disclosure material and can actually lead to disengagement, as members can 'switch off' from reading the material and become disinclined to seek further information.

3.2 Modification of Schedule 10 for pension products

We understand that the Law Council of Australia Superannuation Committee has provided comments to you regarding the need to modify aspects of Part 2 of Schedule 10 to ensure that the PDS disclosure requirements better suit pension products.

ASFA endorses the Committee's comments. In particular, we agree that there should be:

- amendments to item 201 to insert a specific template of fees and costs (and preamble wording) for pension products, omitting any references to 'insurance fees' (unless applicable) and a 'MySuper product';
- amendments to item 210 to insert a pension-specific example of annual fees and costs, again omitting any reference to a 'MySuper product'; and
- specific provision, in item 220, for the example of annual fees and costs for a pension product to be based on the default option for the pension product or, if there is no default option, the investment option under which most of the assets attributable to the pension product are invested.

We have also recommended above, in response to consultation question B4Q2, modifications to the consumer advisory warning which would allow trustees to replace the statement 'your employer may be able to negotiate to pay lower administration fees' with 'you may be able to negotiate to pay lower administration fees', where applicable. If adopted, that recommended modification would also improve the clarity and relevance of the consumer advisory warning given by trustees in relation to pension products.

3.3 Need for clarification – transactional and operational costs

Amendments made to Schedule 10 by the *Superannuation Legislation Amendment (MySuper Measures) Regulation 2013* introduced a distinction in the way that transactional costs are treated for superannuation and managed investment products.

In particular, the definition of 'management costs' that previously applied to both managed investment products and superannuation products is now limited to managed investment products (clause 102), while a new concept of 'indirect costs' applies to superannuation products (as currently defined in clause 101, to be replaced with the definition in new clause 101A, proposed by the draft Class Order).

While 'transactional and operational costs' (defined in clause 103) are specifically excluded from the definition of 'management costs' for a managed investment product (by paragraph 102(2)(b)), and therefore not included in the product's ICR, they are *not* excluded from the definition of 'indirect costs' for superannuation products. This has the result that 'transactional and operational costs' must now be included in the ICR disclosure in the PDS for a superannuation product, and also in the 'Indirect Costs of Your Investment' in periodic statements.

As per our comments in section 1 above, we are of the view that look-through should extend only to the first non-associated entity. We note that the exclusion of 'transactional and operational costs' from the ICR of managed investment products will make it more difficult for a superannuation fund trustee to estimate the transaction costs associated with its investment through such products.

While Information Sheet 197 includes a brief example regarding the treatment of transactional costs as indirect costs, a number of ASFA members have indicated that they would welcome additional guidance on this matter. We note that ASIC will shortly be updating Regulatory Guide 97 *Disclosing fees and costs in PDSs and periodic statements*, and recommend that ASIC includes in that Guide some more detailed comments around the intended treatment of transactional and operational costs for superannuation products.

3.4 Differing concepts of ICR for superannuation and managed investment products

We note that in the current (unmodified) provisions of Schedule 10, the definition of 'indirect cost' applies to superannuation products, while the concept of 'management costs' (clause 102) applies to managed investment products.

The draft Class Order proposes that a common definition of 'indirect costs' will apply to both superannuation and managed investment products. However, the draft Class Order does not result in a common concept of ICR, as the calculation of the ICR for a managed investment product (subclause 104(2)) remains tied to the concept of 'management costs' (clause 102) rather than the new definition of 'indirect costs' (clause 101A). In ASFA's view, this is likely to cause confusion.

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Should you have any queries in relation to the content of our submission, please contact Director Policy Fiona Galbraith on (03) 9225 4021 or by email fgalbraith@superannuation.asn.au, or Senior Policy Adviser, Julia Stannard, on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Glen McCrea

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