RG97 INDUSTRY WORKING GROUP

FEE AND COST DISCLOSURE

GUIDANCE

24 November 2017

On 1 November 2017 ASIC announced an extension beyond 30 September 2017 of its facilitative compliance approach to fee and cost disclosure. During this period an expert external review is to be undertaken to determine how better transparency and comparability of fees and costs may be achieved. ASIC has stated that it still expects funds to provide accurate information about fees and costs to consumers and to comply with the law including recent transitional modifications for property costs and periodic statements.

TABLE OF CONTENTS

CONTRIBUTORS TO GUIDANCE ON FEE AND COST DISCLOSURE

This document was initially prepared by the Australian Institute of Superannuation Trustees and King & Wood Mallesons, and includes guidance from the Financial Services Council's Guidance Note 34 and the work of the RG97 Industry Working Group.

The contents have been informed with discussions and written feedback from ASIC.

RG 97 Industry Working Group (the "IWG")

The IWG was established with the encouragement of ASIC as a forum for all parts of the financial services industry in Australia impacted by ASIC Class Order 14/1252 to share views, develop solutions to unresolved issues and help develop industry guidance on compliance with ASIC Class Order 14/1252. Participants of the group represent all sectors of the Australian financial services industry, including providers of direct investments, retail and industry superannuation funds and peak industry bodies.

The members of the IWG represent the following organisations:

AIST - Australian Institute of Superannuation Trustees

AMP

AMP Capital

ANZ Wealth

ASFA - The Association of Superannuation Funds of Australia

AustralianSuper

BlackRock Inc.

BT Financial Group

BT Investment Management

Cbus

Chant West

Colonial First State

Equip

FSC - Financial Services Council

First State Super

Henry Davis York

IFM Investors

King & Wood Mallesons

National Australia Bank

Perpetual Limited

QIC

Sunsuper

SuperRatings

UniSuper

Vanguard Investments Australia

Industry Participation

The following industry bodies have contributed to the development of this Guidance.

Australian Institute of Superannuation Trustees (www.aist.asn.au)

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 $700 billion not-for-profit 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.

AIST believes that improved transparency reflects good superannuation fund culture and governance. Enhanced transparency supports good governance and conduct and helps to reduce potential agency issues and conflicts of interest which might arise between superannuation fund members and those managing the superannuation savings of members and which can adversely affect a member's net superannuation return. AIST has been active in its involvement with the fees and cost disclosure regime. In mid-2016, AIST (in conjunction with Nathan Hodge from King Wood Mallesons) had drafted an RG97 manual for use by profit-to-member funds. This Guidance has been used as a base document by the Industry Wide Working Group.

Financial Services Council (www.fsc.org.au)

The Financial Services Council (FSC) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency. The FSC has been actively involved in developments in fees and costs disclosure. In late 2016, the FSC issued a Guidance Note designed to address some of the then developing issues in the area: *Guidance Note No. 34 Fees and Cost Disclosure.* The FSC supports comparability of like products with like and open and transparent competition in the financial services sector.

Association of Superannuation Funds of Australia (www.asfa.asn.au)

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire Australian superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through our service provider membership, represents over 90 per cent of the 14.8 million Australians with superannuation.

ASFA believes in the importance of disclosure being effected on a consistent basis to ensure the comparability of products and mitigate the risk of producing misleading outcomes. Disclosure should be accurate, comprehensive and effective in conveying relevant information to consumers in such a way that they can understand and apply it in their decision-making.

King & Wood Mallesons (www.kwm.com)

Recognised as one of the world's most innovative law firms, King & Wood Mallesons offers a different perspective to commercial thinking and the client experience. With access to a global platform, a team of over 2000 lawyers in 26 locations around the world works with clients to help them understand local challenges, navigate through regional complexity, and to find commercial solutions that deliver a competitive advantage for our clients.

Purpose of Guidance on Fee and Cost Disclosure

This Fee and Cost Disclosure Guidance ("**Guidance**") is designed to assist trustees and responsible entities to understand and comply with the amendments to Schedule 10 of the *Corporations Regulations 2001* (Cth) ("**Corporations Regulations**") contained in:

- Class Order 14/1252
- *ASIC Corporations (Amendment and Repeal) Instrument 2015/876* ("**ASIC Instrument 2015/876**")
- *ASIC Corporations (Amendment) Instrument 2016/1224* ("**ASIC Instrument 2016/1224**")
- *ASIC Corporations (Amendment and Repeal) Instrument 2017/65* ("**ASIC Instrument 2017/65**"); and
- *ASIC Corporations (Amendment) Instrument 2017/664* ("**ASIC Instrument 2017/664**").

A consolidated Schedule 10 of the Corporations Regulations, as amended by the above Class Orders and Instruments, and the Explanatory Statements for each can be accessed on the website of each industry body.

This Guidance is not designed for particular types of managed funds, such as separately managed accounts and managed discretionary accounts. However, many of the matters covered in the Guidance will be relevant to these types of products.

How to use it

This Guidance contains recommendations and suggestions for what may be seen as good practice approach to compliance. Whilst consistency in disclosure is one of the desired outcomes of the regime, each trustee and responsible entity is structured and organised differently and will have different practices and procedures. If you are considering adopting the practices outlined in this Guidance, you should first decide which of the practices is relevant and appropriate to your situation and test them out to see if they work for you.

This Guidance is non-binding. A determination not to follow a practice set out in this Guidance does not mean that the practice is inconsistent with the law or indeed that an approach may not be appropriate for the particular fund – an alternative approach in the circumstances may be appropriate. Alternative practices may be equally compliant with the fees and costs disclosure regime and preferable for the particular fund. Trustees and responsible entities must always form a view on how to comply with the fees and costs disclosure regime in a manner which achieves the best outcomes for their members.

This Guidance does not constitute any form of professional advice (including legal advice) and should not be used as a substitute for obtaining your own advice. You should take your own advice and consider your own circumstances.

Ongoing updating of this Guidance

The IWG will continue updating this Guidance. This ongoing work arises from two key areas:

1. Matters deferred or amended by ASIC Instrument 2017/664
   - *Definition of 'property operating costs'*
     - Real property operating costs are excluded from the investment fee / indirect cost ratio of superannuation products in a PDS before 30 September 2018 provided that the PDS includes an estimate of those costs under Additional Explanation of Fees and Costs.
     - Real property operating costs are excluded from the investment fee / indirect cost ratio of superannuation products in a periodic statement for a reporting period ending on or before 29 June 2018 on the condition that there is a statement that these costs have been excluded.
   - *Definition and calculation of implicit costs including market impact*
     - ASIC's amendments were to address the risk of non-disclosure of implicit costs, and including an express requirement for example costs reflected in 'bid-ask' spreads to be included.
   - *Definition and calculation of borrowing costs; definition and calculation of buy-sell spreads for periodic statements*

     For periodic statements for any reporting period ending on or before 29 June 2018, under the modified provisions in Schedule 10, disclosure of the following will not be required:

     - borrowing costs for superannuation products—subject to requirements for inclusion of details about how to obtain information about borrowing costs for each MySuper product and investment option on the fund's website;
     - transactional and operational costs for managed funds;

- disclosure in the total of other fees of any amounts by which tax deductions have been resulted in reduced disclosed fees or costs. This in line with ASIC's view that gross of tax disclosures should be included in the total in RG 97.234; or
- the buy-sell spreads for superannuation products—where the periodic statement states that as it is not reasonable practicable for the trustee to include the buy-sell fee that the member incurred during the period. These amounts for that fee would otherwise have been included in total fees as noted by RG 97.222.

For periodic statements for reporting periods ending on and after 30 June 2018, the modified provisions of Schedule 10 will require this information to be included in the periodic statements.

2. Other potential matters which may need guidance or clarification
   - Interposed vehicles and what constitutes an interposed vehicle (refer to section 3.1).
   - Data collection template (refer to section 5.6).
   - Frequency of undertaking calculations (refer section 5.7).
   - Obligation to monitor changes to fee and costs. The IWG wishes to work with ASIC on practical implementation in a cost effective manner (refer to section 8.11).
   - Platform disclosure, including borrowing and transaction and operating costs (refer to section 10).
   - Clarification whether defined benefit funds are captured.
   - Disclosure of the fees and costs of REITs.
   - APRA reporting.

Questions and answers from ASIC

In addition to Regulatory Guide 97, ASIC has published on its website a series of questions and answers on fees and costs disclosure. This Guidance identifies that there is a question and answer issued by ASIC which is relevant to a particular topic by use of the following:

SEE ASIC QUESTIONS AND ANSWERS

FEES AND COSTS DISCLOSURE

The references are to the Fees and Costs Questions as at the date of this Guidance. However, the Fees and Costs Questions are updated from time to time. It is possible that a question referred to in this Guidance has been re-numbered or removed since the Guidance has been issued. You should take this into account when considering these references.

Good practice

Where a trustee or responsible entity complies with the following sections of this Guidance, it may promote itself as acting in accordance with industry good practice:

4.1 Mapping of fees and costs

5.3 Obtaining fees and costs information on the first layer of interposed vehicles

5.4 Obtaining fees and costs information on downstream entities

6.1 Making reasonable estimates

6.4 Gross or net amounts

8.4 Materiality threshold - Quantum

10 Platforms

A trustee or responsible entity should not promote itself as acting in accordance with industry good practice if it does not comply with all of the above-named sections.

Definitions

In relation to this Guidance:

- The term '**fund**' is used to mean both a superannuation fund and a managed fund.
- The term '**managed fund**' is used to mean a managed investment scheme.
- The term '**member**' is used to mean either or both a member holding a superannuation product and/or an investor in a managed fund.
- The term '**responsible entity**' is used to mean the responsible entity of a managed fund.
- The term '**trustee**' is used to mean the trustee of a superannuation fund.

Warning & Disclaimer

The Guidance is intended to assist trustees and responsible entities but does not replace or exhaustively replicate primary sources of a trustee's or responsible entity's legal obligations, such as general law, legislation, regulations and prudential standards. While the Guidance identifies issues requiring particular care, other content within the Guidance or not covered by the Guidance should not be regarded as any less significant. Trustees and responsible entities will have to make their own judgements on how to apply the information in this Guidance and should seek professional advice if uncertain.

This Guidance should not be relied upon to demonstrate compliance with any legal obligation or standard of conduct expected of trustees, responsible entities or their directors and officers. While this Guidance is a valuable tool for a trustee or responsible entity considering its obligations, adherence to any particular provision or approach does not automatically guarantee compliance or sound prudential outcomes.

The contents of this Guidance have been informed with discussions and written feedback from ASIC. Specific comments from ASIC on various versions of this Guidance have been used as a basis for the footnotes, including where ASIC has expressed a different view, and have been incorporated for reference purposes.

1 INTRODUCTION

1.1 Purpose of fees and costs regime

The fees and costs disclosure regime primarily consists of the rules in Schedule 10 of the Corporations Regulations.

The Explanatory Statement to the *Superannuation Legislation Amendment (MySuper Measures) Regulation 2013* (Cth) confirms that the purpose of disclosure changes was "to improve transparency in the provision of superannuation products."

The IWG supports the principles and purpose of the fees and costs disclosure regime and considers that the objectives of disclosure and reporting are threefold:

- consumer protection;
- enabling analysis of the superannuation and managed fund industries, including benchmarking of fees and costs; and
- enhancing a consumer's ability to compare effectively fees and costs of products.

In determining positions on the fees and costs disclosure regime, the IWG recommends that trustees and responsible entities act in a manner which is consistent with and which furthers the purpose of the regime. If there is significant doubt regarding the need to disclose a particular fee or cost, it is good practice for a trustee or responsible entity to make that disclosure. Similarly if there is significant doubt regarding the appropriate methodology, a trustee or responsible entity should adopt a methodology which best promotes the purpose and objectives of the fees and costs disclosure regime.

1.2 Fees and Cost Disclosure Principles

To assist trustees and responsible entities to act in accordance with the purpose and objectives of the fees and costs disclosure regime, the IWG encourages trustees and responsible entities to adopt and apply the principles outlined below.

These principles help articulate the key outcomes being sought through the fees and costs disclosure regime. They should also help trustees and responsible entities in their interpretation and application of the regime and, in doing so, will support greater consistency of disclosure, improve the comparability of data and lead to improved governance and conduct outcomes.

Principle 1	Improved transparency reflects good culture and governance Transparent disclosure of all fees, underlying costs and conflicts of interest reflects good governance culture and conduct within a fund. Processes supporting disclosure should be designed to be in the best interests of members and disclosure should be clear, concise and effective.
Principle 2	Consistency Disclosure requirements should apply in a consistent manner to all superannuation funds and managed funds, regardless of the fund's structure, investment approach or asset allocation. Consistency across asset classes is needed, e.g. infrastructure investments should be treated in the same way as property and private equity investments.

	A level playing field across all disclosure and reporting requirements is a key goal to assist with enabling consistency. All disclosed costs should be based on actual amounts or a reasonable estimate, unless the law stipulates an alternative method for quantifying cost. Key terms in gathering data, disclosure documents, and reporting data to the regulators need to be consistently labelled and defined.
Principle 3	Comparability Disclosure should enable members to compare the fees and costs of different superannuation funds, and to compare the fees and costs of different managed funds.
Principle 4	Transparency should be provided Trustees and responsible entities should disclose all fees and costs required by law which impact on members' net returns, including the costs borne directly by the trustee or responsible entity and costs which are indirectly incurred and which reduce investment returns. Transparency is needed to both inform members and the market and enable proper analysis of the financial services system. All relevant indirect costs should be disclosed, other than the costs associated with the "real" or "end" asset. Information about fees and costs should be provided in enough detail not to mislead members by omission. Investment jargon should be avoided to the maximum extent possible.
Principle 5	Disclosure should be informative and understandable for members Fees and costs should be disclosed in a clear and comparable format that is informative and useful to both prospective and current members. Disclosure should help members distinguish between what is essential and what is less important. Disclosure documents should be as clear, concise and effective as possible and should clearly explain where members can obtain further information.

1.3 Operational principles

Given both the need for transparency, consistency and comparability, as well as the fact of differing structures across the financial services sector, the IWG has listed a number of operational principles. These operational principles involve a more granular examination as to how standardisation, comparability, level playing fields (etc.) might be better delivered and are designed to help give guidance where prescription may (because of varying fund structures) not assist.

Principle 1	Calculation methodologies and due diligence processes should be documented It is important that calculation methodologies and due diligence processes be documented. This is a useful aid to the governance and monitoring framework.
Principle 2	Fees and costs of new products and investment options should be reasonably estimated

	The fees and costs of new products and investment options should be estimated on a reasonable basis and having taken reasonable steps to arrive at a reasonable estimate, the reasons should be documented.
Principle 3	No investment-related costs should be contained in administration costs and vice versa
Principle 4	Performance fees and performance-related fees should be verifiable and disclosed Performance fees and performance-related fees should be verifiable. Members should be appropriately advised where performance fees and performance-related fees can be charged and how they may impact their investment returns.
Principle 5	Best endeavours to gain information Trustees and responsible entities should use best endeavours to seek information so that the information presented to their members contains a comprehensive assessment of the costs that are incurred on their behalf.
Principle 6	Trustees and responsible entities should monitor changes of fees and costs and document their processes for doing so.

2 ADDITIONAL BACKGROUND INFORMATION

2.1 Regulatory background

Enhanced fee disclosure measures, consisting of the consumer advisory warning, fees and costs table, Additional Explanation of Fees and Costs and Example of annual fees and costs, were inserted into Schedule 10 of the Corporations Regulations in 2005.

New rules for superannuation products requiring disclosure of indirect costs, including a revised fees and costs table and new fee definitions, were introduced into Schedule 10 for superannuation products as part of the Stronger Super reforms in 2013.

Different trustees and responsible entities took different positions on compliance. ASIC's review of industry practices in *Report 398 Fee and cost disclosure: Superannuation and managed products* was that there was significant variation in the disclosure of fees and costs both before and after the 2013 amendments. ASIC Class Order 14/1252 was introduced following ASIC's findings.

ASIC consulted further on the fees and costs disclosure regime throughout 2015. ASIC Instrument 2015/876, issued in November 2015, embodies the outcomes of that consultation period. As a result of continuing consultation, ASIC issued ASIC Instrument 2016/1224 in December 2016 and ASIC Instrument 2017/65 and ASIC Instrument 2017/664 in 2017.

At the time of issuing ASIC Instrument 2015/876, ASIC released an update to Regulatory Guide 97 and has since updated Regulatory Guide 97 a number of times. The updated Regulatory Guide 97 contains guidance on compliance with the fees and costs disclosure rules in the corporations legislation, including the fees and costs disclosure regime.

ASIC has also issued a number Fees and Costs Questions and Answers for the purpose of providing greater clarity on specific fees and costs issues.

2.2 Transition and timing

There are different transitional rules depending on the type of member-facing document[1].

Provided certain conditions are satisfied in relation to a Product Disclosure Statement (**PDS**) involving lodging a notice with ASIC by 31 January 2017 and a report by 28 February 2017, the PDS must comply with Class Order 14/1252 by 30 September 2017. However, there remained an ability to opt in from an earlier date.

SEE ASIC QUESTIONS AND ANSWERS 1

FEES AND COSTS DISCLOSURE

All periodic statements whose outer limit for giving the statement is on or after 1 January 2018 must comply with ASIC Class Order 14/1252 (paragraph 9).

There is also an ability to opt in from an earlier date.

For superannuation products, the outer limit for giving an annual statement is six months and one month for exit statements. As a result, annual statements issued for 12 month reporting periods ending on or after 1 July 2017 and exit statements for members who exit a superannuation product on or after 1 December 2017 must comply with Class Order 14/1252.

1 See paragraphs 8 to 9 of Class Order 14/1252 (as amended).

For managed funds, the default position is that the outer limit for giving both an annual statement and an exit statement is six months. As a result, under the default position annual statements issued for 12 month reporting periods ending on or after 1 July 2017 and exit statements for members who exit a managed fund on or after 1 July 2017 must comply with ASIC Class Order 14/1252.

While ASIC has not changed the above transitional rules, ASIC Instrument 2017/664 amends section 1017D to permit a responsible entity to elect a period between one month and less than six months in which to issue periodic statements. For example, if a responsible entity elected to issue periodic statements within one month, annual statements issued for 12 month reporting periods ending on or after 1 December 2017 and exit statements for members who exit the managed fund on or after 1 December 2017 must comply with the fees and costs disclosure regime.

Where a trustee or responsible entity has opted into the fees and costs disclosure regime earlier <u>for a periodic statement</u>, the periodic statement must contain a statement that Class Order 14/1252 (as amended) applies to the document (paragraph 9(b)). It is recommended that this statement be included in the section of the periodic statement which outlines total fees and costs.

2.3 Common investment structures

Different investment structures may produce different outcomes for the purposes of fees and costs disclosure. See Appendix A for some information on common investment structures.

2.4 Global references

Information on various global references may be found at Appendix B.

3 INTERPOSED VEHICLES

3.1 At a glance

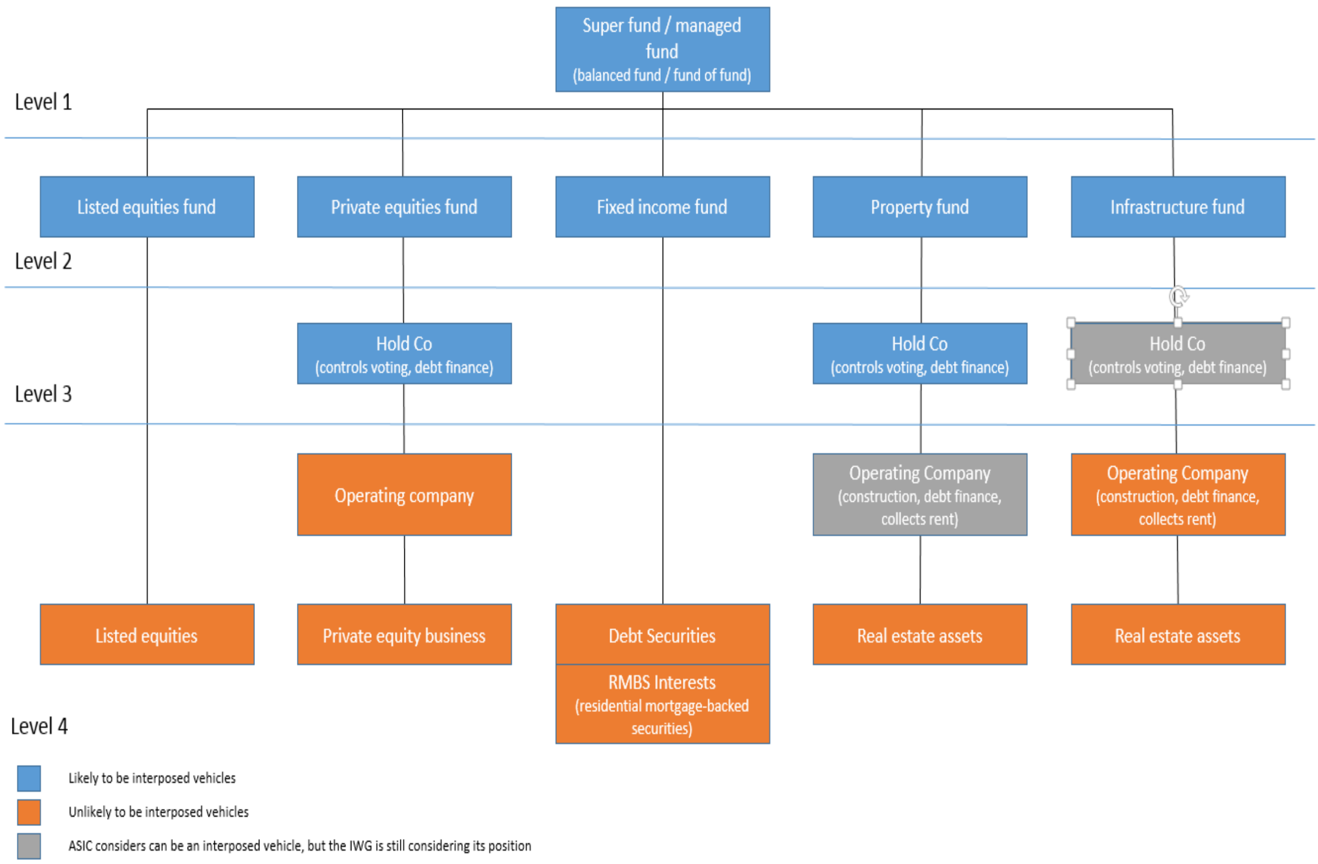
Trustees and responsible entities must collect information on, and disclose the costs of, an underlying investment if the underlying investment is an "interposed vehicle".

An underlying investment is an interposed vehicle if it satisfies either an asset test or a PDS test, and the platform test is not satisfied.

Under the asset test, an underlying investment is an interposed vehicle if the trustee or responsible entity has reasonable grounds to believe that more than 70% of its assets are financial products, such as shares, that are not excluded from being counted. The assets which are excluded are those which provide access to real property and infrastructure entities or which provide control over a second entity that has 70% or less of assets invested in financial products.

Under the PDS test, an underlying investment is an interposed vehicle if a retail client looking at the PDS and other promotional material would reasonably consider the investment to be an interposed vehicle.

To take the following example for a balanced managed fund or balanced investment option in a super product:



In this example:

Asset class	Treatment under the Asset Test	Treatment under the PDS Test
Listed equities (i.e vehicle providing exposure to listed equities including managed funds, ETFs and LICs)	The Level 2 entity would be an interposed vehicle, but not the Level 4 investment	Where member disclosure describes the balanced fund or option as being invested in a listed equities asset class, the Level 2 entity would be an interposed vehicle but not the Level 4 investment
Private Equity	The Level 2 and Level 3 entities would be interposed vehicles, but not the Level 4 investments	In general, the IWG considers that a member would believe that they are obtaining an exposure to the businesses in which the private equity fund invests. On this basis, other than exceptionally, the private equity fund is an interposed vehicle. However, the underlying business and the operating company that has acquired the business may not be interposed vehicles.
Property	None of the entities will be interposed vehicles	ASIC's view is: • none of the Level 4 entities are interposed vehicles if member disclosure identifies them as being held in an equities asset class • each of the entities are interposed vehicles if member disclosure identifies them as being held in a property asset class. The IWG is still considering its position in light of the changes introduced by ASIC Instrument 2017/664.

Infrastructure	None of entities will be interposed vehicles	ASIC's view is: • none of the Level 4 entities are interposed vehicles if member disclosure identifies them as being held in an equities asset class • each of the entities are interposed vehicles if member disclosure identifies them as being held in a property asset class. The IWG is still considering its position in light of the changes introduced by ASIC Instrument 2017/664.

3.2 Introduction

An interposed vehicle is a body, trust or partnership that meets either an asset test or a PDS test, and the body, trust or partnership is not excluded under a platform test.

The interposed vehicle test applies where property attributable to a superannuation product or managed fund is invested in the body, trust or partnership. Such an investment can occur where an equity / ownership interest is held in the body, trust or partnership. It can also occur where the investment consists of a life policy (ie an investment account contract or an investment-linked contract)[2].

Mandates are not of themselves interposed vehicles. However, investments held within a mandate may be interposed vehicles. For example, where a mandate requires the investment manager to invest in Australian equities and the investment manager determines to implement the mandate by investing the portfolio in a series of unlisted equities funds, the unlisted equities funds will be interposed entities (but not the mandate itself).

Identification of interposed vehicles is important because the fees and costs of interposed vehicles must be disclosed.

When considering whether an entity is an interposed vehicle, the IWG recommends adopting the following process:

- Look at each investment held by the fund or investment option or another interposed vehicle. With each investment, identify if there is an investment in or through a body, trust or partnership (e.g. units in an unlisted unit trust, a policy held through a life company, shares in a private company, a partnership interest in a limited partnership, shares in a listed investment company, units in an exchange traded fund).
- If there is an investment in a body, trust or partnership, consider whether the asset test is satisfied. If the asset test is satisfied, apply the platform test.

[2] ASIC's view is that such an investment can also include a debt interest.

- If the asset test is not satisfied, consider whether the PDS test applies. If the PDS test is satisfied, apply the platform test.
- If the platform test is satisfied, the entity is not an interposed vehicle.

The asset test is based on what the trustee or responsible entity believes or has reasonable grounds to believe.

In contrast to this, both the PDS test and the platform test involve an objective consideration of the relevant factors eg PDS and marketing material. Accordingly, neither the PDS test nor the platform test are determined by a trustee's or responsible entity's subjective belief.

The IWG recommends that trustees and responsible entities make their determinations of whether an entity is an interposed vehicle by reference to objective and reasonable factors, and document and retain relevant records of their determinations.

3.3 Asset test

Broadly, the asset test will be satisfied if the trustee or responsible entity believes or has reasonable grounds to believe that more than 70% of the assets of the entity are invested in financial products (clause 101B(1)). According to Regulatory Guide 97, the 70% limit was chosen as it is indicative that the entity's principal business or activity is that of investing.

In applying this test:

- the trustee or responsible entity must consider the value of the assets of the entity being tested (and not the number of assets)
- securities and other financial products held by the entity being tested in real property and infrastructure entities[3] must be disregarded
- the trustee or responsible entity must disregard securities that confer control[4] over a second entity, unless more than 70% of the assets of the second entity are invested in financial products ("Control Exception").

SEE ASIC QUESTIONS AND ANSWERS 14

FEES AND COSTS DISCLOSURE

The focus of the asset test on "assets" and "control" mean that structure is an important factor in applying the asset test and so an understanding of investment structures is necessary for the asset test.

Having undertaken an assessment of an entity under the asset test, re-assessment under the asset test would not ordinarily be required while an investment is held. However, a re-assessment should be undertaken if new or additional information is obtained by the trustee or responsible entity or if the trustee or responsible entity has reason to believe that the previous assessment may no longer be applicable – for example, because the structure may have changed during the period of holding the vehicle in the relevant financial year.

To satisfy the asset test, the trustee or responsible entity will need to have information that gives them the belief on reasonable grounds to believe that an entity meets the elements of the asset test. These grounds may arise from knowledge about the particular factual circumstances of the entity or about the investment strategy applied in an interposed vehicle through which financial products in the entity are held. In this regard, Regulatory Guide 97 refers to the unanimous judgment in *George v Rockett* (1990) 170 CLR 104 where the High Court held that 'reasonable grounds' for a state of mind requires the existence of facts which are

[3] See clause 101B(6) of Schedule 10 for the definition of "infrastructure entities".

[4] For these purposes, "control" takes on the meaning in section 50AA of the *Corporations Act 2001* (Cth).

sufficient to induce the state of mind in a reasonable person – that is, the trustee or responsible entity must have more than a mere reason to suspect.

The question for trustees and responsible entities then is whether, having regard to their particular factual circumstances, a reasonable person would form the view on reasonable grounds from the information available that the assets test is met.

Trustees and responsible entities should refer to Regulatory Guide 97 for ASIC's view on how a determination of the asset test might be satisfied. Importantly, ASIC indicates that there is no requirement to undertake inquiries outside the trustee or responsible entity to ascertain facts and determine if they would provide reasonable grounds to believe the assets test is met. However, trustees and responsible entities should take into account their broader legal and regulatory obligations in this regard e.g. the obligation to act honestly, efficiently and fairly as an Australian financial services licensee, a trustee's due diligence obligations under the Superannuation Industry (Supervision) Act 1993 (Cth) (**SIS Act**) and the APRA prudential standards and a responsible entity's duties in light of *In the matter of Macquarie Investment Management Limited* [2016] NSWSC 1184.

In addition, it is noted that in cases of doubt as to whether an entity is an interposed vehicle, ASIC encourages trustees and responsible entities to make reasonable inquiries taking into account how material the outcome would be to disclosed fees and costs. This may include seeking information from the operator of the entity to determine whether the entity and, if applicable, any other entity in which it invests would meet the asset test.

If the trustee or responsible entity is of the view that there are reasonable grounds to believe at least 70% of the assets of the entity consist of financial products, the entity is an interposed vehicle. On the contrary, if the trustee or responsible entity does not believe the information it has meets the reasonable grounds standard, the asset test is not met.

Examples of entities that would be interposed vehicles under the asset test, taking into account the above and ASIC's views are:

- life insurance companies;
- listed investment companies;
- exchange-traded funds;
- pooled superannuation trusts;
- private equity funds; and
- hedge funds.

Examples of entities that would not be interposed vehicles on the same basis under the asset test are:

- ASX listed companies, such as BHP Billiton Ltd, Brambles Ltd, RIO Tinto Ltd, Transurban Group, Telstra, Woolworths Ltd and Woodside Petroleum;
- listed and unlisted infrastructure funds; and
- real estate investment trusts (**REITs**) and unlisted property funds.

3.4 PDS test

There are three limbs to the PDS test.

As the focus of the PDS test is on disclosure in PDSs and promotional material, the particular structures for different types of investments (eg REITs) do not affect the outcome of this test.

SEE ASIC QUESTIONS AND ANSWERS 13 AND 14

FEES AND COSTS DISCLOSURE

Under the first limb, an entity is an interposed vehicle if, having regard to the PDS for the relevant superannuation product or managed fund (and other information issued by the trustee or responsible entity), a security or interest in the entity could reasonably be regarded from a member's perspective as the means by which the benefit of the investment is obtained – in other words, it is a vehicle to access the end investment, rather than being the end investment.

Under the second limb, an entity is an interposed vehicle if either:

- the description of the product or investment option; or
- the description of the assets of the product or investment option,

in the PDS for the relevant superannuation product or managed fund (and other information issued by the trustee or responsible entity) refers to "property", "real estate", "land" or a similar term and the trustee or responsible entity directly or indirectly holds real property or an interest in land through that product or option.

However, an entity is not an interposed vehicle under the second limb (but may still be an interposed vehicle under the first limb or third limb) if:

- the reference to "property" etc is merely part of a reference to an entity (whether specified or not) that directly or indirectly invests in real property, interests in land or to certain types of physical infrastructure; and
- a retail client could not reasonably believe that the product, investment option or asset may be intended for persons predominantly intending to benefit from real property, land or infrastructure entities[5].

Under the third limb, an entity is an interposed vehicle if the PDS for the relevant superannuation product or managed fund (or any other information issued by the trustee or responsible entity) refers to the product or investment option as being directly or indirectly invested in or through the entity (whether specified or not).

However, an entity is not an interposed vehicle under the third limb (but may still be an interposed vehicle under the first limb or second limb) if either:

- the entity is an infrastructure entity[6]; or
- the entity is listed or will be listed, the investment strategy for the product or option relates to or is measured by a widely used index of listed assets, the strategy for the product or option is to invest in listed assets, listed assets represent at least 80% of the assets of the investment strategy and the value of the securities or financial products of the investment strategy does not exceed 30% of the value of the index.

5 See the definition in clause 101B(4B) of Schedule 10.

3.5 Platform test

Refer to section 10 for more information on platform disclosure.

Under the platform test, a vehicle is not considered to be an interposed vehicle if:

- the relevant disclosure documents for the platform states that a member may give instructions, directs or requests for financial products to be acquired;
- the issuer of the relevant disclosure documents has published a list of financial products in relation to which the instructions, directions or requests may be given that includes a security or interest in the entity; and
- the arrangement under which the instructions would be acted on is a custodial arrangement as defined in section 1012IA(1) of the *Corporations Act 2001* (Cth) ("Corporations Act").

SEE ASIC QUESTIONS AND ANSWERS 22

FEES AND COSTS DISCLOSURE

3.6 Downstream entities

Complex issues can arise where there is a chain of investment vehicles, and a trustee or responsible entity makes an investment in the first entity of the chain. In this instance, the trustee or responsible entity (at the "head" of a potential chain) will need to carefully consider whether the definition of interposed vehicle is met for each entity in the chain. Where an entity is an interposed vehicle and itself invests in a second interposed vehicle, then the costs of investing in the second vehicle must be considered in calculating the indirect costs of the "head" product or option.

Trustees and responsible entities are required to take reasonable steps to determine the fees and costs of each entity in the chain that is an interposed vehicle. However, in forming a view on what steps to take they can consider whether inclusion of any relevant amounts from such "downstream" entities would represent a material factor or influence in a reasonable member's decision to invest in or remain invested in the superannuation product or managed fund. It may well be, for example, that the impact of any lower-level costs is so diluted or miniscule so as to be reasonably seen as irrelevant to any investment decision.

However, if there are many such entities, then cumulatively they could have a material impact and so it may be appropriate to make a reasonable estimate of the overall cost associated with these entities and adding this estimated amount to the disclosed costs. The remoteness of the holding should not lead to a lower estimate, but it may not be reasonable to take steps to quantify with the same certainty as more direct holdings.

Trustees and responsible entities should determine, having regard to these principles, whether the "downstream" entities meet the definition of interposed vehicle and, if so, how to obtain information on the fees and costs of those entities.

Once an entity in a chain is determined as not meeting the interposed vehicle definition, then any vehicles below this vehicle are not interposed vehicles in relation to the relevant option or product.

4 FEES AND COSTS PRESCRIBED BY LAW

4.1 Mapping of fees and costs

GOOD PRACTICE

The IWG has developed a table which provides an outline of the different types of fees and costs that can be incurred and how they are treated for disclosure purposes.

It has also developed a specific mapping table for private equity investments, outlining the different types of fees and costs that can be incurred for private equity investments and how they are treated for disclosure purposes.

These tables can be accessed at the website of each industry association.

4.2 Meaning of fee and cost

The disclosure of fees and costs is complex because for superannuation products, some costs are disclosed as fees – for example, investment-related costs are disclosed as an investment fee – and, for managed funds, fees are disclosed as costs – for example, the responsible entity's fees are disclosed as management costs.

Notwithstanding this, it is important to determine which amounts are "fees" and which amounts are "costs" at general law (as opposed to disclosure purposes). The distinction is important because:

- in the fees and costs table, fees must be calculated prospectively (for the 12 months from the date of the PDS) in a PDS and, except for new products and investment options, costs (other than performance fees for managed funds) must be calculated retrospectively (ie. for the financial year before the PDS was issued)[6]
- a trustee can elect to disclose some or all costs of interposed vehicles of a superannuation product as an indirect cost ratio, and
- material or significant increases in fees must be notified at least 30 days beforehand but material or significant increases in costs can be notified afterwards.

The amount that a trustee or responsible entity charges for performing their duties should be treated as a "fee", and all other amounts should be treated a "cost" (including fees charged by interposed vehicles and costs incurred by a trustee or responsible entity recovered from a fund under its rights of indemnity or reimbursement). For example, while investment management fees (ie the fees payable to an investment manager under a mandate) have the word "fee" in the description, they are a cost under this approach as they are not an amount charged by a trustee or responsible entity for performing its duties.

A shorthand way of thinking about this is to consider that amounts which are charged directly by a trustee or responsible entity and for which it hasn't received an invoice is a "fee", and amounts for which the trustee or responsible entity receives an invoice from a third party is a "cost".

4.3 Administration fee

(Superannuation only)

Generally speaking, an administration fee is a fee that relates to the administration or operation of a superannuation fund and includes costs that relate to that administration or operation, other than:

- borrowing costs;

[6] In the statutory fee example, responsible entities must calculate fees that are not charged directly to member accounts using the indirect cost ratio methodology set out in clause 104(2) (clause 218A(3) of Schedule 10).

- indirect costs that are not paid out of the superannuation fund that the trustee has elected in writing will be treated as indirect costs and not fees, incurred by the trustee of the fund or in an interposed vehicle or derivative financial product; and
- costs that are otherwise charged as an investment fee, a buy/sell spread, a switching fee, an exit fee, an activity fee, an advice for or an insurance fee,

(Clauses 101 and 209A of Schedule 10).

The following are common examples of amounts which would normally be expected to be included as an administration fee, unless (where permitted) an election is made to disclose the amount as part of the indirect cost ratio:

- fees charged by the trustee for administration and operation of the superannuation fund
- fees charged by an administrator appointed by the trustee
- where such fees are charged separately, administration fees charged by a custodian appointed by the trustee
- audit costs
- costs of providing member communications (for example, call centres)
- regulator levies
- costs of product development
- overheads, including accommodation, internal staff costs in member services teams and information technology
- costs of professional indemnity, directors and officers and other insurance.

4.4 Investment fee

(Superannuation only)

An investment fee generally includes fees that relate to the investment of the assets of a superannuation fund and includes:

SEE ASIC QUESTIONS AND ANSWER 24

FEES AND COSTS DISCLOSURE

- fees in payment for the exercise of care and expertise in the investment of those assets (including performance fees); and
- costs that relate to the investment of assets of the fund, other than borrowing costs, indirect costs that are not paid out of the superannuation fund that the trustee has elected in writing will be treated as indirect costs and not fees, incurred by the trustee of the fund or in an interposed vehicle or derivative financial product and costs that are otherwise charged as an administration fee, a buy/sell spread, a switching fee, an exit fee, an activity fee, an advice for or an insurance fee,

(clauses 101 and 209A of Schedule 10).

The following are common examples of amounts which would normally be expected to be included as an investment fee, unless (where permitted) an election is made to disclose the amount as part of the indirect cost ratio:

- fees charged by the trustee that relate to the investment of the assets of a superannuation fund
- investment fees, including performance fees, charged by an interposed vehicle
- fees, including performance fees, charged by an investment manager, general partner or trustee of a fund in which the superannuation fund invests
- costs of OTC derivatives that are included as an indirect cost

- custody fees charged by a custodian or prime broker appointed by the trustee or an interposed vehicle, other than those included in the administration fee
- securities lending fees charged by a custodian or prime broker
- income retained by a custodian or prime broker in lieu of charging a fee for securities lending activities (or charging a higher fee)
- internal staff costs in investment teams
- explicit transaction costs, such as broker fees and costs associated with deals / bids (including where the deal or bid has failed), including costs of legal and tax professionals
- fees paid to asset consultants
- valuation costs
- property operating costs from, if certain conditions are satisfied, 1 October 2018.

Investment fees do not include:

- property development costs
- the fees and costs of infrastructure entities or private equity businesses
- until 30 September 2018, property operating costs (if certain conditions are satisfied)
- implicit transaction costs
- the purchase price of an asset, and
- income taxes.

Importantly, the amount of a fee disclosed in a PDS should include the amount of any goods and services tax (**GST**), less reduced input tax credit, and any stamp duty on that fee or cost (clause 204(7) of Schedule 10).

4.5 Election to treat amounts as indirect cost ratio

(Superannuation only)

While the default position is that costs of an interposed vehicle are included as an investment fee in the fees and costs table, a trustee may (but is not obliged to) elect to disclose these costs as an indirect cost ratio (see the definitions of investment fee and administration fee in clauses 101 and 209A of Schedule 10). However, a trustee cannot disclose costs incurred by the superannuation fund directly as an indirect cost ratio.

SEE ASIC QUESTIONS AND ANSWERS 7 AND 9

FEES AND COSTS DISCLOSURE

This election introduces a distinction between the investment fee / administration fee (on the one hand) and the indirect cost ratio (on the other). It can assist in showing members amounts which are incurred in interposed vehicles. However, it does not affect the total fees and costs disclosed. For example, the statutory fee example is based on the total of all 3 components.

An election to disclose costs of an interposed vehicle as an indirect cost ratio must be made in writing, and must be made before the PDS, periodic statement or other relevant disclosure is issued. The fees and costs disclosed in periodic statements issued from the date of the PDS should adopt an approach which is consistent with the written election.

At law, a trustee may determine not to make any election, it may elect to disclose all costs of interposed vehicles as an indirect cost ratio or it may elect to disclose only certain costs as an indirect cost ratio.

A trustee may make an election each time a PDS or periodic statement is issued. Alternatively, it may make a "standing" election, and so only make a new election if there is a change to the fee and cost arrangement which affects the disclosure in the PDS, periodic statements or other relevant disclosure. A trustee relying on a standing election should take care with the drafting of the election to ensure that it does not accidentally omit amounts from the election which it had intended to be included. Where a trustee makes an election, a copy of the relevant election should be retained in the fund's records eg as part of the due diligence papers for the PDS.

A trustee should also ensure that the election is made by an appropriately authorised person within the organisation. This could be the board of directors, a board or management committee or an individual with the requisite delegation.

Where a trustee elects to disclose costs of an interposed vehicle in an investment option in the indirect cost ratio, it must provide a single indirect cost ratio amount for that investment option (clause 104(1) of Schedule 10). This does not prevent the trustee from also disclosing the components of the indirect cost ratio, provided the PDS is clear, concise and effective.

Example 1: XZY Pty Limited does not charge any fees but the following tables summarises the relevant costs:

	Estimated investment-related costs of superannuation product	Estimated investment-related costs of interposed vehicles	Estimated administration-related costs of superannuation product
FY16	0.5%	0.5%	0.4%
FY17	0.4%	0.6%	0.5%

If XYZ made no indirect costs ratio election, XZY would disclose in its PDS at the end of FY16:

Investment Fee: 1.0% pa = 0.5% pa (investment costs of the superannuation fund for FY16) + 0.5% pa (investment-related costs of interposed vehicles for FY16)

Administration Fee: 0.4% pa = 0.4% pa (administration costs of the superannuation fund for 2016)

If XYZ elected to disclose all costs of interposed vehicles as indirect costs, the PDS would show:

Investment Fee: 0.5% pa (investment costs of the superannuation fund for FY16)

Administration Fee: 0.4% pa (administration costs of the superannuation fund for FY16)

Indirect cost ratio: 0.5% pa = 0.5% pa (investment-related costs of interposed vehicles for FY16)

Importantly, XYZ cannot elect to disclose the costs of the superannuation fund as part of the indirect cost ratio.

Under this charging structure, the FY17 amounts are not relevant to the PDS[7]. Further, the total costs disclosed do not change as a result of the election.

Example 2: ABC Pty Limited charges a fee, and pays all costs of the superannuation fund from the proceeds of that fee. The following table summarises the relevant fees and costs:

	Trustee fee	Estimated investment-related costs of interposed vehicles
FY16	1%	0.5%
FY17	1.2%	0.6%

7 If the FY17 amounts are materially higher than the FY16 amounts, trustees should consider also including information on FY 17 amounts under Additional Explanation of Fees and Costs to reduce the risk of the PDS containing misleading or deceptive information.

Say half of the trustee fee is administration-related and half is investment-related and ABC made no indirect costs election, ABC would need to disclose in its PDS at the end of FY16:

Investment Fee: 1.1% pa = 0.6% pa (proportion of trustee fee for FY17) + 0.5% pa (investment-related costs of interposed vehicles for FY16)

Administration Fee: 0.6% pa = 0.6% pa (proportion of trustee fee for FY17)

If ABC elected to disclose the costs of interposed vehicles as indirect costs, the PDS would show:

Investment Fee: 0.6% pa (proportion of trustee fee for FY17)

Administration Fee: 0.6% pa (proportion of trustee fee for FY17)

Indirect cost ratio: 0.5% pa = 0.5% pa (investment-related costs of interposed vehicles for FY16)

Under this charging structure, both the FY 16 and FY17 amounts are relevant to the PDS.

4.6 Management costs

(Managed funds only)

Generally speaking, management costs are the total investment-related and administration-related fees and costs of a managed fund and its interposed vehicles.

Schedule 10 defines "management costs" to mean:

- an amount payable for administering the managed fund;
- for a custodial arrangement, the cost involved, or amount paid or payable, for gaining access to, or participating in, the arrangement;
- distribution costs;
- other expenses and reimbursements in relation to the managed fund;
- amounts paid or payable for investing in the assets of the managed fund;
- amounts deducted from a common fund by way of fees, costs, charges or expenses, including amounts retrieved by an external fund manager or a trustee or responsible entity and amounts deducted from returns before allocation to the fund;
- estimated performance fees;
- any other investment-related expenses and reimbursements, including any associated with custodial arrangements, fees in payment for the exercise of care and expertise in the investment of those assets (including performance fees); and
- indirect costs of the managed fund and of interposed vehicles.

The following are common examples of amounts which would normally be expected to be included as management costs:

- fees charged by the responsible entity for administration, operation and management of the managed fund
- fees charged by a custodian or prime broker appointed by the responsible entity or an interposed vehicle
- audit costs
- costs of providing member communications (for example, call centres)
- costs of product development
- overheads, including accommodation, internal staff costs in member services teams and information technology
- regulator levies
- costs of professional indemnity, directors and officers and other insurance

- investment fees, including performance fees, charged by an interposed vehicle
- management fees, including performance fees, charged by an investment manager, general partner or trustee of a trust in which the managed fund invests
- costs of OTC derivatives included as an indirect cost
- securities lending fees charged by a custodian or prime broker including income retained by a custodian or prime broker in lieu of charging a fee for securities lending activities (or charging a higher fee)
- internal staff costs in investment teams
- fees paid to asset consultants
- valuation costs
- expense recoveries and abnormal costs.

Management costs do not include property development costs or the operational costs of infrastructure entities or private equity businesses. Nor do they include transactional and operational costs (other than applicable OTC derivative costs), including property operating costs, or costs that a member would incur if he or she invested directly in a specific asset.

Normally, the purchase price of an asset and income taxes are not management costs. Importantly, the amount of a fee disclosed should include the amount of any goods and services tax (GST), less reduced input tax credit, and any stamp duty on that fee or cost (clause 204(7) of Schedule 10).

4.7 Indirect costs

Indirect costs include:

- *first limb*: amounts which have reduced or will reduce (as applicable) whether directly or indirectly the return on the relevant investment option or managed fund
- *second limb*: amounts which reduce the amount or value of the income of or property attributable to an interposed vehicle in or through which the property attributable to the investment option or managed fund is invested
- *third limb*: amounts paid or payable by a third person who may make payments that form part of the return on, or the value of, the product or option, and the amounts paid or payable increase the returns or value of the property or option or provide a benefit to the trustee or responsible entity that is retained by the trustee or responsible entity.

Platform operators should understand that the platform test is relevant to the second limb only.

To prevent double counting, an amount is not an indirect cost where it is charged to a superannuation member as a fee, where it is a fee as defined in clause 209A of Schedule 10 or where it is an insurance fee.

Trustees and responsible entities should ensure they apply each limb when determining whether the fees and costs of an entity should be included in the indirect costs of the superannuation product or managed fund.

Indirect costs are also deemed to include certain OTC derivative costs (see section 6.7).

4.8 Borrowing costs

Refer to section 7.8 for information on the disclosure of borrowing costs.

Borrowing costs may arise in a number of circumstances, including (but not limited to):

- strategic borrowing costs – borrowing costs supporting a fund's investment strategy, for example, where money is borrowed to purchase an asset for a geared fund or where securities are borrowed as part of a fund's short selling investment strategy

- operational borrowing costs – usually incidental borrowing costs for short-term operational purposes, for example, where money is borrowed (eg in the form of a temporary bank overdraft) to pay a fund's expenses or a withdrawal benefit pending the sale of fund assets.

Trustees of superannuation funds do not normally themselves incur significant borrowing costs because of the prohibition against borrowing (subject to certain limited exceptions) in section 67 of the SIS Act. However, section 67 does not prevent them from investing in interposed vehicles which borrow.

The following table summarises different types of borrowing costs that may be incurred when money or securities are lent.

Type of borrowing cost	Explanation	When incurred?
Interest	A fixed or variable rate amount that the lender charges on money/securities lent to the borrower. Includes the interest component on discount securities.	Ongoing
Establishment fee	Payable on the signing of a loan agreement or on the first advance under it.	Upfront
Commitment fee	Payable on account of the lender putting aside money or making the necessary arrangements to ensure it is able to make the loan.	Upfront/Ongoing
Line fee	Line fees on revolving credit facilities are payable on the total approved credit facility limit. Line fees are the equivalent of commitment fees, but in the context of a letter of credit or bank credit facility.	Upfront
Administrative fees	Payable to the lender for the ongoing administration of the loan facility.	Ongoing
Margin fees	Equivalent to an interest charge, payable to the lender who has lent money for the purpose of investing.	Ongoing

Lenders of a borrowing arrangement may include, but are not limited to, banks, providers of a margin lending facility and prime brokers. Depending on the borrowing arrangement and lender, the type of fee or cost incurred by the borrower may differ and care should be taken to ensure any disclosed borrowing costs do not also include other costs that may be more appropriately disclosed elsewhere within a PDS. While borrowing costs associated with the borrowing of money for the purchase of an asset may be clearly identifiable as borrowing costs, costs incurred by a trustee or responsible entity engaging a prime broker may include a number of cost components, each of which may need to be assessed differently for the purposes of Regulatory Guide 97.

For example, a prime broker (the lender) is engaged by a trustee or responsible entity (the borrower) as part of the product's long/short investment strategy. The prime broker may bucket a number of services together and provide these services to the trustee or responsible entity, including securities lending (where securities are temporarily lent to the trustee or responsible entity), financing (where the prime broker lends money to the trustee or responsible entity to purchase securities), global custody and trading and settlement services.

Financing fees and costs and costs incurred by the borrower of securities are generally borrowing costs and maybe charged as a rate of interest on the value of a loaned money, cash deposits, security short positions and on synthetic financing products. However, global custody costs and trading and settlement costs (which may include brokerage) should not be classified as borrowing costs and should be classified as management costs (in respect of a managed fund) and transaction costs respectively.

4.9 Transactional and operational costs

Refer to section 6.6 for information on the calculation of transactional and operational costs. Refer to section 7.3 for information on the disclosure of transactional and operational costs.

What are transactional and operational costs?

"Transactional and operational costs" are defined in clause 103 of Schedule 10 of the Corporations Regulations to include:

SEE ASIC QUESTIONS AND ANSWERS 16

FEES AND COSTS DISCLOSURE

- brokerage;
- buy-sell spreads;
- settlement costs (including custody costs);
- clearing costs;
- stamp duty on an investment transaction;
- for unlisted assets, any part of the acquisition price that exceeds the price at which the asset could have been disposed
- for listed assets, any part of the acquisition price that exceeds the bid price, and
- property operating costs.

Operating costs of the superannuation product or managed fund should not be included as transactional and operational costs (although, as noted above, those costs which satisfy the meaning of property operating costs are expressly included as transactional and operational costs).

The law expressly provides that transactional and operational costs of superannuation products do not include borrowing costs or OTC derivative costs. There is no such exclusion for managed funds.

Further, while "transactional and operational costs" are excluded from being management costs of a managed fund, conceptually certain operational costs incurred in the management and operation of a managed fund (i.e. custodial and administration fees) do fall within the definition of management costs. As a result, some operating costs may be transactional and operating costs, while others may be management costs.

What transaction costs fall within the meaning of transactional and operational costs?

Transaction costs are the costs incurred when assets are bought or sold. Different transaction costs arise depending on the assets involved. For example, the transaction costs incurred in buying or selling listed securities and derivatives are different to the transaction costs in buying or selling property, private equity and infrastructure businesses.

There is no generally accepted definition of transaction costs. However, as an example, a definition provided by the International Financial Reporting Standard 9: *Financial Instruments* defines transaction costs is:

> *. . . incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have occurred if the entity had not acquired, issued or disposed of the financial instrument.*

Transaction costs can be divided into “explicit” and “implicit” costs.

Explicit transaction costs

Explicit transaction costs are often amounts which are paid out from a fund to implement a transaction. However, they can be paid for in other ways, such as being netted off against sale proceeds. Explicit transaction costs are can normally be objectively ascertained from internal or external data sources.

Explicit transaction costs applicable to listed equity, fixed income and other more commonly traded asset classes include:

- brokerage;
- buy-sell spreads of underlying pooled investment vehicles;
- settlement costs (including custody settlement costs);
- clearing costs; and
- stamp duty on an investment transaction.

Explicit transaction costs applicable to unlisted asset classes like property, private equity and infrastructure include:

- due diligence costs (eg tax and other experts);
- stamp duty on the purchase of property, infrastructure investments and/or private equity investments;
- sales commission on the sale of property;
- costs of member reporting/meetings for private equity, property and infrastructure investments
- transaction related Investment Advisory Committee expenses for private equity, property and infrastructure investments
- legal, advisory and other professional costs; and
- any failed deal costs.

A description of the different types of fees and costs that can be incurred for private equity investments, including explicit transaction costs, and how they are treated for disclosure purposes can be accessed at the website of each industry association.

Implicit transaction costs

Transactional and operational costs are now defined to include the difference between the acquisition price for an asset and either its disposal price (for unlisted assets) or its bid price (for listed assets). For simplicity, we have referred to these costs as “implicit costs” (including market impact). It is noted that there is no clear or specific legal or regulatory rule for the calculation of these costs.

Implicit transaction costs cannot be known objectively, and so must typically be estimated.

In most cases, the implicit transaction costs of a listed asset will equate to the bid-ask spread for the asset. Bid-ask spreads apply to assets such as listed equities and fixed interest. A “bid-ask spread” is the difference between the best bid and the best offer[8] – or the difference between the highest price a buyer is willing to pay and the lowest price a seller is willing to accept. Consider this simple example, ABC Fund wants to

8 ASIC Report 452, Review of high-frequency trading and dark liquidity, October 2015.

purchase 1,000 shares at $10 (bid) and XYZ Fund wants to sell those shares for $10.50 (ask). The difference between the bid and offer is 50 cents, meaning the bid-ask spread is 50 cents.

The bid-ask spread is determined by supply and demand and so can be a measure of liquidity of an asset. In another sense, it measures the negotiation process on price. There may be instances where the majority of trading, both purchases and sales, are being transacted at a single price, in which case trades are transacted at a “natural market price”. In such instances no spread is observed and as such no implicit cost is incurred.

In determining the implicit cost, ASIC has indicated that trustees and responsible entities may also be required to consider market impact (i.e. the fact that the order may itself have an impact on the bid-ask spread cost). Market impact is described in more detail below.

A bid-ask spread should not be confused with a product’s buy/sell spread, which is treated as an explicit cost because it is an actual charged cost. A bid-ask spread is the difference between the bid price and the ask price for an asset. A buy/sell spread is an amount charged by a trustee or responsible entity on unit holder application and redemption requests, in order to recover transaction costs incurred to meet the member’s request.

Depending on a number of variables and the size of an order, which may need to be completed in multiple batches by a broker, an order may itself have an impact (known as “market impact”) on the transaction price of an asset during the execution of the order.

Consider this simple example of market impact, with consideration to timing opportunity costs9. ABC Fund wants to purchase 100,000 shares of XYX Plc, a low liquidity listed company currently trading at $10 per share. ABC Fund instructs its broker that is wants to buy the shares. The buy order for 100,000 shares enters the market, however, the buy order cannot be filled in one trade and the broker is forced to separate the order into four separate batches, as there is no one seller looking to sell 100,000 shares of XYZ Plc. While the first batch of shares is able to be purchased at the current trading value, as the purchase of subsequent batch are completed the trading price of XYX Plc increases to $10.50, in order to entice more sellers into the market to meet ABC Fund’s buy requests. Following completion of the purchase of XYZ Plc by ABC Fund, the trading price of XYZ Plc retreats back towards its original trading value and settles on $10.20 after a period of time, as normal market demand for the shares of XYZ Plc resumes. In this simplified case, the market impact cost of the trade is the lost value incurred in buying the asset above its $10.20 valuation.

Changes to the price of an asset, whether it be a share or a bond, for example, may be seen by changes to the bid-ask spread of the asset during the completion of the multiple batch orders. Increased demand for an asset may push the bid-spread out from the current mid-price, again to entice more sellers into the market, while having little effect on the ask-spread.

Property operating costs

Transactional and operational costs include property operating costs, although trustees may exclude these amounts from transactional and operational costs in their PDSs until 30 September 2018 if certain conditions are satisfied.

As part of the ongoing management of property assets certain expenses are generally incurred throughout the life of the investment. Such expenses may include, but are not limited to:

- council & water rates;

9 There is no Australian or internationally agreed method of calculating market impact and in reality market impact can be difficult to quantify because it depends on a variety of factors: type of instrument, size of order, timing of the transaction, execution quality, liquidity of the underlying market, actions of other market participants during execution, etc.

- utilities; and
- lease renewal costs.

For a managed fund, property operating costs form part of transactional and operational costs (there is no transitional period for this disclosure) but are not part of management costs.

It is common practice for property operating costs to be recovered (either explicitly or implicitly) from tenants of the property. The IWG is considering how such costs are to be calculated under the fees and costs disclosure regime.

OTC derivative costs

For superannuation products, OTC derivative costs that are included as investments fees or indirect cost ratio are specifically excluded from transactional and operational costs.

For managed funds, the following types of OTC derivative costs are included as transactional and operational costs:

- costs of OTC derivatives used for hedging purposes
- OTC derivatives costs which would result from the incurring of transactional and operational costs in relation to the ultimate reference asset, and
- transaction costs of OTC derivatives.

For further information on OTC derivative costs, see sections 4.10 and 6.7 of this Guidance.

Capitalised transaction costs

In practice, some costs may be added to the acquisition value of the asset for capital gains tax purposes – for example, advisory fees, due diligence costs and other acquisition / disposal costs. Where a cost is added to the cost base of an asset, the cost is considered to be "capitalised".

Capitalised costs are often incurred when building or financing assets. Such costs may include advice fees, due diligence and other acquisition or disposal fees and costs which are capitalised into the valuation for CGT purposes.

From an accounting perspective, capitalised costs are not expenses as a lump sum amount in the period they were incurred but are recognised over a period of time on a depreciated basis.

These amounts should not be treated as part of the purchase price under the fees and costs disclosure regime. The accounting treatment of these amounts does not necessarily affect their treatment under the fees and costs disclosure regime. Instead, capitalised costs must be disclosed as expenses of the fund when they are incurred, even if they will provide a benefit in later financial years. If the capitalised cost is incorporated into the cost base, but not amortised, then the full cost should be recorded at the time of acquisition of the asset. If the capitalised costs are amortised, then the amortised amount should be recorded each year until the amortisation ceases.

Recovering transaction costs

There are a variety of ways in which transaction costs can be recovered from those members that transact. These include through the imposition of:

- A buy/sell spread, which is applied to the unit price of a product on each member transaction and reflects the estimated transaction costs incurred in the buying and selling of the product's assets to meet member flows. The buy-sell spread is applied with consideration to the equitable treatment of all unit holders in the product, to ensure returns of the product are not negatively impacted as a result of the investment decisions of individual members. If transaction costs are recovered (in whole or in part) through a product's buy-sell spread, this should be stated in the product's PDS, along with an explanation of how this amount (being the buy-sell spread applied to each member transaction) is determined.[10]

- Different definitions of buy-sell spread are found in Schedule 10 of the Corporations Regulations, depending on whether you are considering the buy-sell spread of a superannuation product or a managed fund. For superannuation products, a buy-sell spread is a fee to recover transaction costs incurred by the superannuation product in relation to the sale and purchase of assets of the product. Importantly, the buy-sell spread is deemed to be a fee and it can only relate to transaction costs incurred directly by the superannuation product and not indirectly through interposed vehicles.[11] Further for superannuation products, the amount charged by a buy-sell spread must be no more than it would be if it were charged on a cost recovery basis.[12] For managed funds, regulations do not specifically limit the amount of the buy-sell spread to cost recovery, although this is generally market practice.
- The deduction of a transaction cost allowance from the unit price (so that a single unit price – or "mid-price" – is charged).

Trustees should remember that the *Superannuation Industry (Supervision) Act 1993* requires a buy/sell spread to only be charged on a cost recovery basis. To the extent that explicit transaction costs are not fully recovered from the member, they should be reflected in the investment fee or indirect cost ratio.

More information on how transaction costs are recovered through unit pricing can be found:

- in ASIC Regulatory Guide 94 *Unit pricing: Guide to good practice* dated August 2008; and
- FSC Standard No. 8 Scheme Pricing.

4.10 OTC derivative costs

Refer to section 6.7 for information on the calculation of OTC derivative costs. Refer to section 7.4 for information on the disclosure of OTC derivative costs.

ASIC amended Schedule 10 to include costs of OTC derivative calculated in particular manner. ASIC's stated purpose for including OTC derivatives costs as part of a product's indirect costs is that such investments can be used to gain economic exposure to assets in a similar way to investing in interposed vehicles and may include imbedded costs akin to management/investment costs. Accordingly, the costs associated with investing in OTC derivatives are required to be disclosed, as would those costs associated with investing in an interposed vehicle. Subject to certain provisions, which are described in detail below, costs of obtaining exposure through OTC derivatives should be treated as management costs for managed funds, or fees or costs for superannuation products. For completeness, it is noted that this treatment is not strictly limited to pure derivatives and can extend to securities and investments in managed funds that have an embedded derivatives such as deferred purchase agreements.

Many standard form derivative financial products are traded on regulated, transparent and liquid financial markets. This may include regulated financial markets such as licensed exchanges (for example, ASX Limited) and licensed swap execution facilities (for example, Bloomberg TradeBook and SEC/CFTC regulated SEF's

10 Refer to clause 209(j)(iii) of Schedule 10.

11 Refer to clause 101 of Schedule 10 and section 29V(4) of the SIS Act.

12 Refer to section 99C of the SIS Act.

based in the US). Derivative securities which are traded on a financial market are generally non-negotiable securities and are to be treated like other listed securities (i.e. shares) with regard to their cost assessment.

For OTC derivatives which are:

- not options, the costs are to be measured as the difference between the underlying return (which may be negative) on the asset or index that the trustee or responsible entity is gaining exposure to through the derivative and the actual return or loss the trustee or responsible entity has received over the relevant period. The actual and underlying return generally needs to be determined for the previous financial year.
- options, the cost that needs to be calculated is the lesser of the premium and the difference between the acquisition price and the price to dispose of the derivative immediately after its acquisition.

In practice, the calculation requirements for OTC derivatives lead to various potential bases for calculating the associated costs. They include:

- a cost charged as an amount payable to the counterparty (for example, comprising a component of an option premium);
- reflected in the difference between how much the counterparty has to pay (or set off) and the value of the underlying asset or index; and
- by providing a price to acquire the OTC derivative that is higher than would be payable on its disposal.

However, for managed funds (but not for superannuation products), these OTC derivative costs are not indirect costs (but will form part of its transactional and operational costs) where either:

- hedging: the OTC derivative is acquired or disposed of for the primary purpose of avoiding or limiting the financial consequences of fluctuations in, or the in the value of, receipts or costs of the managed fund; or
- to the extent that the difference would result from the incurring of transactional and operational costs in relation to the ultimate reference assets.

5 COLLECTION OF DATA

5.1 Relying on managed fund PDSs

(Superannuation only)

For a superannuation product that invests in an unlisted managed fund, the managed fund would often (but not always) be an interposed vehicle. Where the managed fund is an interposed vehicle, the trustee would need to include the fees and costs of the managed fund in their indirect cost calculations.

In calculating the fees and costs to disclose for a superannuation product, the trustee should take into account the fees and costs information in any PDS for a managed fund. This would apply where the reporting period for the managed fund aligns with the relevant reporting period of the superannuation product.

However, there are a number of differences between fees and costs disclosure for superannuation funds and managed funds. Accordingly, a PDS for a managed fund might not contain all the fees and costs information that the trustee would need to disclose. This will mean that the trustee may not be able to solely rely on the managed fund PDS in isolation – see the tables which can be accessed at the website of each industry association.

While the trustee should take into account the fees and cost information in the PDS, it should consider what additional steps it will take (if any) to obtain the required additional information. The trustee should take into account the cumulative impact of any differences and make appropriate allowances when calculating the estimate.

Where a trustee considers that reliance on the managed fund PDS disclosure is reasonable on the basis that there is no reason to believe it is materially misleading or deceptive (eg the investment in the managed fund represents an immaterial part of an investment option and the additional information would be likely to affect the fees and costs disclosure by the materiality threshold outlined in section 8 below), a trustee may consider simply relying on the information in the managed fund PDS. However, where the additional information would be likely to affect the fees and costs disclosure by more than the materiality threshold, the trustee should seek additional fees and costs information.

5.2 Summary of process

At a high level, the process for obtaining fees and costs information should, where practicable, involve:

- sending requests for fees and costs information to investment managers and providers of direct investments in the first layer of interposed vehicles using standard form requests;
- follow up at least twice those who have not responded within the requested timeframe;
- review the information obtained for consistency between investment managers and providers of direct investments and determine if there are any outliers; and
- for any outliers, ask additional questions to test the fees and costs information provided and determine whether or not the amounts need to be re-calculated.

Trustees and responsible entities will need to balance competing factors – the longer the investment manager or fund manager has to provide the information, the more accurate the information will be. On the other hand, trustees and responsible entities will need to ensure that they have sufficient time to collate the fees and costs information obtained from multiple sources, and to "scrub" and test the information and ask further questions.

Trustees and responsible entities will need to have an ongoing process to allow them to reasonably estimate the fees and costs that must be reported for PDSs, annual / quarterly statements and exit statements.

5.3 Obtaining fees and costs information on the first layer of interposed vehicles

GOOD PRACTICE

The fees and costs disclosure regime does not impose a legal obligation on an entity to provide fees and costs information to trustees and responsible entities. Accordingly, where the information is not available from an entity, trustees and responsible entities must look to other means to obtain fees and costs information such as obtaining information from custodians or other parties.

It will generally be the case that the information requested by a trustee or responsible entity and that is required to be disclosed will be made available to it by the relevant entity. In some instances, the requested information will not be held by the entity or it is not able to reasonably access or estimate that information. The entity may wish to communicate the reason for the information not being available at that time and whether it will be available at some time in the future. In this circumstance, the trustee or responsible entity will need to determine a reasonable estimate by other means (refer to section 6.1).

It is open to trustees and responsible entities to rely on information provided by their custodian or from their investment managers / provider of a direct investment. Where information is being sought from investment managers and providers of direct investments, good practice involves:

- trustees and responsible entities requesting fees and costs information from all investment managers and providers of direct investments (eg general partners, trustees) on the first layer of interposed vehicles regardless of the expectations of receiving that information;
- where an investment manager or provider of direct investment does not provide the requested information, trustees and responsible entities taking reasonable efforts to follow up the investment manager or provider;
- if follow up efforts with an investment manager are not successful, and the relevant entity has the requisite information reasonably available to it, trustees and responsible entities considering their powers under the terms of the investment management agreement and point the manager towards the relevant contractual clauses which obliges it to provide the information; and
- if follow up efforts with the provider of a direct investment are not successful, a trustee or responsible entity should consider the range of powers open to it to support the provision of available information. This includes considering its powers to issue a notice pursuant to section 13 of the *Financial Sector (Collection of Data) Act 2001* (Cth) and rights to obtain information found in governing rules and side letters.

If the cost of enforcing legal rights to obtain information outweighs the benefits arising from greater certainty in the expected cost amount then it may not be reasonable to take legal action to enforce those rights.

For all new direct investments, it is good practice for trustees and responsible entities to:

- undertake appropriate due diligence on the investment to understand the costs that might be incurred by the fund and its interposed vehicles[13]; and
- ensure the agreement with the provider of the direct investment contains appropriate contractual obligations to facilitate the provision of relevant fees and costs information.

[13] For superannuation funds, see section 52(6)(vii) of the SIS Act and APRA Prudential Standard SPS 530. For managed funds, see section 601FC(1) of the Corporations Act and *In the matter of Macquarie Investment Management Limited* [2016] NSWSC 1184.

Schedule 10 does not contain any express limits on the obligation to disclose fees and costs information of interposed vehicles. Accordingly, trustees and responsible entities should fully understand any limits that the provider of a direct investment seeks to impose on the contractual obligation to provide fees and costs information and take appropriate legal advice. For example, where the provider of a direct investment seeks to limit the obligation to provide fees and costs information where it is prevented to do so by law, the trustee or responsible entity should ensure that it fully understands what laws could apply in this situation before determining whether or not to accept the limitation.

A refusal by the provider of a direct investment to agree to such provisions does not of itself prevent a trustee or responsible entity from making the investment, but the trustee or responsible entity should take the provider's position on fees and costs disclosure into account when determining whether to invest.

5.4 Obtaining fees and costs information on downstream entities

GOOD PRACTICE

It is good practice for trustees and responsible entities to:

- seek to rely on investment managers and providers of direct investments to provide fees and costs information on interposed vehicles which are downstream entities;
- seek to rely on providers of direct investments to provide fees and costs information on interposed entities in which that entity invests; and
- request fees and costs information about downstream entities from all investment managers and providers of direct investments regardless of the expectations of receiving that information.

Trustees and responsible entities should make this expectation clear when seeking fees and costs information from investment managers and providers of direct investments, and be satisfied that any contractual obligations to provide fees and costs information extends to information about downstream entities.

Accordingly, where a trustee or responsible entity obtains fees and costs information from an investment manager or direct investment entity, the trustee or responsible entity should clearly understand whether the information includes fees and costs of any interposed vehicles.

Where the requested information about downstream entities is not provided, it is good practice for a trustee or responsible entity to use reasonable efforts to obtain that information from the investment manager or provider of direct investment, and consider its contractual and other legal powers to support the request.

5.5 Quality of information

A number of legal obligations are impacted by the quality of fees and costs information, including:

- the offences in Part 7.9 of the Corporations Act of providing defective PDSs and the defences where a trustee or responsible entity can show it took reasonable steps to ensure that the disclosure document or statement would not be defective; and
- the definition of indirect costs which refers to making a reasonable estimate of costs.

In light of these legal obligations:

- trustees and responsible entities should use the most accurate information available to them at the time. In most cases, this will not be audited information, but audited information should be used where it is available;
- in most cases only unaudited information will be available, trustees and responsible entities should consider whether there is anything which suggests that information would be unreliable and would produce misleading or deceptive results. If nothing shows it to be unreliable, then trustees and responsible entities should use unaudited information. Even if the information is not entirely reliable,

the trustee or responsible entity should consider whether the risk of the PDS being misleading or deceptive is greater if the information is excluded. If the trustee or responsible entity determines that the information cannot be relied on, it must then consider other means for forming a reasonable estimate of those costs; and

- where a trustee or responsible entity is only provided with information about some fees and costs but not others, it should include that information in its calculations and make a reasonable estimate of the other fees and costs.

5.6 Template for requesting fees and costs information on interposed vehicles

The IWG is in the process of developing a template for requesting fees and costs information. Once finalised, it will be considered good practice for trustees and responsible entities to use the template when requesting fees and costs information from a relevant entity.

5.7 Timeframes for obtaining costs information of interposed vehicles

For those who issue periodic statements annually, the timeframe for requesting full fees and costs information each year should link to the timeframe for issuing an annual statement. It is recommended that requests for fees and costs information be sent four months before the annual statement is due to be issued.

Trustees and responsible entities should contact the investment manager and provider of direct investments within a reasonable time of sending a request for information to obtain confirmation of whether information will be provided (eg one month).

Trustees and responsible entities must also ensure they have reasonable estimates to provide fees and costs information for exit statements issued throughout the year.

The IWG is of the view that calculations only need to be performed annually. However, new costs information should be obtained if the trustee or responsible entity becomes aware of a material change that is likely to impact the existing fees and costs disclosure. The IWG is in discussion with the regulators regarding more regular reporting.

6 CALCULATING FEES & COSTS

6.1 Making of reasonable estimates

GOOD PRACTICE SECTION

SEE ASIC QUESTIONS AND ANSWERS 7, 8 AND 12

FEES AND COSTS DISCLOSURE

Estimates of fees and costs will need to be prepared by:

- a trustee or responsible entity in relation to the fees and costs of the superannuation product or managed fund where it does not know the exact amount of a fee or cost of the product or fund;
- a trustee or responsible entity in relation to the fees and costs of an interposed vehicle where it cannot obtain information about the fees and costs of the vehicle; and
- the operator of an interposed vehicle in relation to its fees and costs and the fees and costs of further downstream entities where it does not know the exact amount of a fee or cost of the vehicle.

In practice, it is expected that a trustee or responsible entity should know or be able to readily obtain information on most of the fees and costs incurred by the superannuation product or managed fund itself. There will be situations where a trustee or responsible entity may need to make an estimate of some of these costs, but such situations will be limited. Trustees and responsible entities should make a reasonable estimate of all fees and costs of a superannuation product or managed fund, even where that information is not known.

For example, a trustee or responsible entity may not be able to readily obtain information on the brokerage costs incurred by a product. In this case, the trustee or responsible entity should obtain information on what brokerage normally costs for brokers of that type and form an estimate of the brokerage costs of the product based on that information.

Where a trustee or responsible entity is not able to obtain information about a cost incurred by a superannuation product or managed fund, the trustee or responsible entity should form a reasonable estimate of the amount through other means (eg an estimate based on the costs in a similar investment portfolio) and work with any relevant investment manager and custodian to obtain a reasonable estimate of that cost for future years.

More commonly, trustees and responsible entities will need to make reasonable estimates of the fees and costs of interposed vehicles, particularly where the provider of those entities does not provide fees and costs information. Where a trustee or responsible entity cannot obtain information about the interposed vehicle, the trustee or responsible entity must consider how it could form a reasonable estimate of the vehicle's costs.

The legal obligation is to ensure that estimates are reasonable in the circumstances and not be materially misleading or deceptive. However, it may be possible to estimate different amounts for a fee or cost due to factors such as different methodologies or different assumptions. Trustees and responsibilities should be aware that selecting a lower reasonable estimate may result in a document being materially misleading or deceptive or, at best, becoming out of date quickly.

For new products and investment options, a trustee or responsible entity should base a reasonable estimate on what the trustee or responsible entity expects to incur, having regard to the arrangements for the product, the types of assets and investment strategy, amongst other information that they may hold at the time of making an estimate.

Regulatory Guide 97 states that in making a reasonable estimate, a trustee or responsible entity may use information they have and make reasonable assumptions. ASIC will accept an estimate that the trustee and responsible entity believes is their best estimation, if the trustee has taken reasonable steps to formulate it. In some cases further steps may be reasonable, specifically to obtain information about costs for disclosure.

In Regulatory Guide 97, ASIC outlines the following as ways by which a trustee or responsible entity make a reasonable estimate:

- using any information normally provided by the interposed vehicles
- seeking further information from the interposed vehicles directly or indirectly
- using information otherwise gathered to make decisions about acquiring or disposing of the investment
- using information about costs of similar investments or in similar markets;
- making inquiries and undertaking research into the typical costs of the relevant kind of investment, and
- estimating the costs based on the amounts the trustees and responsible entities would incur if they were to make the investments themselves, rather than rely on a third-party provider.

A trustee or responsible entity could also consider engaging an expert consulting firm to provide estimates for certain types of fee and cost amounts.

6.2 Forward looking vs retrospective

SEE ASIC QUESTIONS AND ANSWER 7

FEES AND COSTS DISCLOSURE

Different fees and costs are required to be disclosed on a prospective or retrospective basis, depending on where they are incurred. You should refer to the mapping tables available from each industry association's website.

In the main fee table of a PDS, fees charged directly by trustees and responsible entities should be calculated on a prospective basis. Most other fees and costs will be disclosed on a retrospective basis.

The indirect cost ratio and the cost component of investment fees and administration fees disclosed in a PDS for a superannuation product should be calculated for the financial year prior to the issue of the PDS (clauses 104(2) and (2A)). The cost component of management costs (other than performance fees) disclosed in the main fee table in a PDS for a managed fund should be calculated for the financial year prior to the issue of the PDS (clause 104A) (refer to section 6.6 for more information).

However, if the product or investment option was not offered at least 11 months of the financial year before the date of the PDS, the amount to be disclosed is to be determined based on the trustee or responsible entity's reasonable estimate of the amount that will apply for the current financial year, adjusted to reflect a 12 month period (clause 104(2) and (2A) and clause 104A of Schedule 10).

Costs incurred in a prior financial year are generally easier to calculate but are not necessarily a reliable indicator of what those costs will be in future years. For example, changes to investment strategy (eg change in asset allocation) and changes to service providers (eg investment managers) can materially change the costs payable. A trustee or responsible entity should consider whether the change is sufficiently fundamental to result in the establishment of a new investment option or fund. Otherwise, a trustee or responsible entity will need to consider what additional disclosure it should include to manage the risk of disclosure being misleading or deceptive, such as by disclosing that the amounts are based on a prior year which is not a reliable indicator of future year amounts or by also disclosing the estimated amount for the future[14]. It is

[14] If an estimate of fees or costs for the current or a future year is included in a PDS, there must be reasonable grounds for the forecast and appropriate disclosure included to reduce the risk of providing a misleading or deceptive forecast. The

ASIC's view that such additional disclosure should be included in the Additional Explanation of Fees and Costs section of the PDS.

6.3 Gross vs net amounts

The issue of gross vs net arises in three ways.

GOOD PRACTICE

Firstly, whether percentage amounts should be disclosed on a gross asset value or a net asset value. The IWG considers it good practice to disclose percentage amounts based on net asset value. In any event, amounts included in the indirect cost ratio for a super product must be calculated on a total average net asset value (clause 104(1)). Further, managed funds must also base management costs not deducted from member accounts in their statutory fee example on total average net asset value (clause 104(1A)).

Secondly, whether fee or cost amounts can be netted off by other income amounts and so only the net amount of the two is disclosed. Trustees and responsible entities should disclose the gross amount of fees and costs. For example, where a cost is netted off against particular sources of income and the trustee, responsible entity or interposed vehicle normally records the net amount in its accounts, the amount to be disclosed under the fees and costs disclosure regime is the gross amount.

The third situation where gross vs net arises relates to the effect of taxation. This is discussed further in section 6.4 below.

6.4 Effect of taxation

In a PDS, fees or costs must be shown gross of income tax (but including GST and any applicable stamp duty) and net of any applicable reduced input tax credits. The Explanatory Statement to the regulations which originally inserted Schedule 10 provided that disclosure in this manner is required as the impact of any entity level tax deductions and the extent to which they will be passed on to members or product holders through lower after tax fees or costs is not known at the time of preparing a PDS.

On the other hand, the Corporations Regulations require that:

- amounts disclosed in the transaction list section of periodic statements must be net of tax, and
- for reporting periods ending after 29 June 2018, the "Other fees of your investment" and "Indirect costs of your investment" amounts to be gross of tax.

6.5 Calculating performance fees and performance-related fees

Refer to section 7.5 for information on the disclosure of performance fees and performance-related fees.

inclusion of a forecast could also mean the forecast becomes out-of-date or misleading or deceptive as information becomes available.

A “performance fee” is defined in Schedule 10 as an amount paid or payable, calculated by reference to the performance of a superannuation product, an investment option or a managed fund.

Schedule 10 defines “performance” to include income and capital appreciation.

SEE ASIC QUESTIONS AND ANSWERS 10 AND 11

FEES AND COSTS

ASIC’s position in Regulatory Guide 97 is that the term does not include performance fees paid under a mandate when the mandate does not relate to the fund as a whole or to a particular investment option. Further, it considers that fees based on the performance of an interposed vehicle through which a subgroup of assets of an investment option are held, or for the management of a subgroup of assets of an investment option or a managed fund, should not be called a performance fee in the PDS.

“Performance-related fees” are not defined in the law, but the IWG considers them to be fees related to performance which do not satisfy the legal definition of “performance fee”. For example, performance fees payable to an investment manager who manages a sub-group of assets within an investment option or managed fund.

Most trustees do not charge performance fees in relation to superannuation investment options. However, some of these investment options invest their assets through mandates or into one or more managed funds where fees related to performance apply. Except as outlined below, such amounts are performance-related fees.

A number of responsible entities will charge performance fees. The managed fund may also invest in interposed vehicles where fees related to performance apply. Except as outlined below, such amounts are performance-related fees.

Where the assets of a product or investment option invest solely in an interposed vehicle and a fee related to performance is charged in that investment vehicle, that amount is a performance fee of the product or investment option.

Performance fees that are charged by a trustee or responsible entity – including performance fees for superannuation products payable to trustees, performance fees payable to the responsible entity of a registered scheme and any performance fees directly paid by members – must be estimated and disclosed on a prospective basis. Amounts in an interposed vehicle which are classed as performance fees must be estimated and disclosed on a historical basis.

Given the difficulties with accurately predicting future investment performance, it may not be possible to reasonably estimate performance fees on an exclusively prospective basis. However, trustees and responsible entities should:

- Use the previous completed financial year’s actual performance fees as a "proxy/default" for the performance fee estimates for the next financial year unless they have a reasonable belief at the time of issuing the PDS that those past performance fees are likely to be materially misleading or deceptive and cause the PDS not to be up-to-date[15].

[15] On one view, last year's fee can only be used if it is a reasonable forecast of the performance fee that will be paid prospectively. It is not sufficient to use simply because of a reasonable belief that it is not misleading. On this basis, the earlier discussion about updating PDSs when new information is known to trustees and responsible entities is relevant to any estimate used for a performance fee. On the other hand, the proposal to rely on the previous year is considered to reduce gaming and promotes consistency. In addition, it will reduce the need for updating during the year if it clear it is based on the previous year which may not be representative and is provided to illustrate the calculation of the disclosed formula for calculating the performance fee.

- Where the previous completed financial year's actual performance fees are considered likely to be materially misleading or deceptive, trustees and responsible entities may instead base their estimate on average annual performance fees charged for (to the extent available) the past completed three financial years to take into account potential higher market volatility over a shorter period e.g. where the past financial year alone has resulted in an abnormally low or high performance fee.[16]
- Where neither of the above is considered to be a reasonable basis for estimating typical ongoing performance fees, trustees and responsible entities should make their estimate using whatever they consider constitutes a reasonable basis in the relevant circumstances.

Performance-related fee estimates should be based on the actual amount of those fees charged by such interposed vehicles or investment managers during the last financial year (except for new products and investment options).

6.6 Calculating transactional and operational costs

Refer to section 4.9 for explanatory information on transactional and operational costs. Refer to section 7.3 for information on the disclosure of transactional and operational costs.

As with the assessment of other fees and costs under the fees and costs disclosure regime, trustees and responsible entities are required to assess transactional and operational costs with consideration to the previous full financial year of the superannuation product or managed fund, and with consideration to transactional and operational costs incurred both directly and indirectly i.e. in interposed vehicles. For a new product or investment option, a reasonable estimate of the transactional and operational costs likely to be incurred during a full financial year of the option or product should be disclosed by the trustees or responsible entity.[17]

SEE ASIC QUESTIONS AND ANSWERS 15 TO 19

FEES AND COSTS DISCLOSURE

Transactional and operational costs of OTC derivatives are to be assessed and disclosed based on specific requirements. For further information, refer to section 6.7.

Where the previous financial year figures are not considered to be a good indication of the typical ongoing transaction costs, trustees and responsible entities are encouraged to provide additional disclosure explaining the previous year figures and why ongoing transaction costs are likely to be materially different. Where reasonable, a forecast of the range of typical ongoing costs that may be expected can be provided.

While some explicit transaction costs are likely to be recorded by a fund's administrator for fund accounting purposes, it is expected that many components of a product's or option's transactional and operational costs will need to be calculated or estimated each year.

Calculating explicit transaction costs

All explicit transaction costs should be included as transactional and operational costs for the period in which they are incurred.

16 The requirement is to base the example on typical ongoing fees. Accordingly, the previous completed financial years actual performance fee will be misleading if it is not within the range of what will be typical. The same applies for any averaged figure.

17 Refer to clause 209(j)(ii) of Schedule 10 of the Corporations Regulations.

Calculating implicit transaction costs[18]

While the definition of transactional and operational costs expressly includes implicit transaction costs, the method of calculating such implicit costs is not specified in the law.

Currently, there is no standardised Australian or international methodology for calculating implicit transaction costs. Trustees and responsible entities may determine their own method of calculating or reasonably estimating implicit transaction costs, however, the IWG recommends that such costs be calculated with consideration to the following:

- *Actual bid-ask spread*: Recording the actual bid and ask price of an asset at the time of transacting;
- *Estimated security bid-ask spread*: Estimating the bid-ask spread for a security at the time of transacting. Trustees and responsible entities may have regard to publicly disclosed security pricing sources (such as market data providers); and
- *Estimated asset class bid-ask spread*: Determining an estimated bid-ask spread for a particular asset class and applying a uniform bid-ask spread to all trades in the specific asset during the period of review. In determining estimated bid-ask spreads for an asset class, trustees and responsible entities should have regard to the asset type (i.e. equity, fixed income, emerging market, etc), asset features (i.e. liquidity, duration, investment grade, etc) and historic trading data of the asset (i.e. historic market data, trustee's or responsible entity's own trading experience, etc).

The method chosen for estimating a security or asset class bid-ask spread may result in different outcomes and in some instances certain pricing sources may not be appropriate for the determination of bid-ask spreads. In choosing any method of estimating a security or asset class bid-ask spread, trustees and responsible entities should be able to reasonably justify their choice.

It is possible for the bid-ask spread cost to be zero for certain transactions. For example, if a purchase involves a seller crossing a pre-existing spread to accept a bid.

In determining the appropriate method for calculating implicit transaction costs, including whether it is reasonable to recognise the fully calculated bid-ask spread at the time of purchasing the asset or whether an implicit cost assessment at the point of purchase and sale of an asset is more reasonable and appropriate, trustees and responsible entities should have regard to the trading activity being undertaken (i.e. was the trade crossed on market, is the asset expected to be held to maturity, typical trading strategy of the product, etc), their own unit pricing policies and other issued regulatory guidance (including ASIC/APRA Regulatory Guide 94 *Unit pricing: Guide to good practice* dated August 2008) and Standard 8 issued by the FSC.

See section 6.7 for a discussion of the calculation of bid-ask spreads of OTC derivatives.

Calculating market impact costs

It is generally accepted that market impact can be difficult to quantify because it depends on a variety of factors: type of instrument, size of order, timing of the transaction, execution quality, liquidity of the underlying market, actions of other market participants during execution, etc.

The recognised difficulty in calculating market impact costs has resulted in the development of differing international transaction cost disclosure regulations (some of which are still in draft form). For example, while the European Markets in Financial Instruments Directive (commonly referred to as MIFID II) does not require an assessment of market impact costs, the European Packaged Retail and Insurance-based Investment Products (PRIIPs) regulations do, as do the proposed U.K. Financial Conduct Authority (FCA) UK DC workplace pension scheme reporting regulations.

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18 This section is subject to review and consideration by ASIC.

The FCA have commented that the transaction cost analysis industry has "developed with few common standards, and a wide range of definitions of precisely what constitutes market impact".[19] Proposed FCA regulations addressing transaction cost disclosure therefore do not seek to specifically define market impact. Similarly, neither Schedule 10 nor Regulatory Guide 97 specifically make reference to market impact costs. ASIC's RG 97 Questions and Answers No. 15 does, however, state that "in estimating transaction cost it is important to estimate the market impact, where this is material, as is more likely for large orders."

The effect of market impact can be mitigated by intentionally splitting a large order into separate orders, placing each order with a different broker and staggering the transmission of each order into the market over a period of time. In this instance, buyers and sellers in the market are less likely to realise the separate orders are part of one large order and as a result the price of the asset being traded may be less likely to move as a result of this particular trade activity. Such trading techniques, however, do not come without their own risks and may in some instances negatively contribute to a product's investment performance.

At the time of publication of this Guidance there continues to be little or no international regulatory alignment on what constitutes market impact or how it should be assessed (if at all). With this mind and with consideration to the aforementioned concerns connected to the disclosure of market impact costs **if a trustee or responsible entity chooses to include market impact costs in its fee and cost assessment, it is** advised to use best efforts in the calculation and reporting of market impact costs, where such costs are reasonably considered to be a material[20] component of the overall transaction cost for a particular trade. An assessment of market impact costs may, therefore, not be required for all trading activity. For example, a trustee or responsible entity may consider that market impact is not applicable, having regard to factors such as:

- the level of liquidity in the market;
- the approach of the investment manager to order management; or
- the size of the product or its orders relative to the size of the market.

It is expected that this Guidance will be monitored and reassessed with consideration to industry and regulatory developments both within Australian and internationally.

6.7 Calculating OTC derivative costs

Refer to section 7.4 for information on the disclosure of OTC derivative costs.

The method of calculating or estimating the costs of OTC derivatives differs depending on whether or not the derivative is an option. Accordingly, for OTC derivatives which are:

Options

The cost of an option is the lesser of (i) the premium and (ii) the difference between the acquisition price (i.e., the ask price) and the price to dispose of the option (i.e., the bid price). The difference between the ask price and the bid price will almost always be lower than the premium.

Options include, but are not limited to, options on single stocks, indices, currencies, commodities, bonds, credit default swaps, as well as swaptions, caps and floors.

SEE ASIC QUESTIONS AND ANSWERS 20 AND 21

FEES AND COSTS DISCLOSURE

Entry cost: The cost of entering into an option position is equal to the difference between the true option price and the actual option price that has been transacted. The true option price is generally equal to the mid of the bid and ask option price rates quoted by the derivative counterparty. The

19 FCA consultation paper CP 16/30 Transaction cost disclosure in workplace pensions.

20 Refer to ASIC RG 97 Questions and Answers 15

cost of entering into an option position is therefore generally equal to 50% times the bid-ask spread quoted by the derivative counterparty.

The entry cost is recognised at the time the option position is opened (whether it be a long position or a short position), irrespective of when the option matures.

Exit cost: Once an option position has been taken, it can be either:

- held to maturity: in which case no exit cost is incurred. The total cost of the option position is therefore limited to the entry cost, which is generally 50% times the bid-ask spread and which was recognised at the time the option position was opened; or
- exercised prior to maturity: in which case no exit cost is incurred. The total cost of the option position is again limited to the entry cost, which is generally 50% times the bid-ask spread and which was recognised at the time the option position was opened; or
- closed-out prior to maturity by entering into an offsetting transaction: in which case the cost of entering into the offsetting option transaction is generally 50% times the bid-ask spread at the time the offsetting option transaction is entered into. The total cost of the option position is therefore generally 50% times the bid-ask spread recognised at the time the option position was taken, plus 50% times the bid-ask spread recognised at the time the offsetting option position was transacted.

Interest rate swaps

The cost of an interest rate swap includes an assessment of the difference between the bid rate and the ask rate of the swap.

Entry Cost: The cost of entering into an interest rate swap is generally the difference between the true swap rate and the actual swap rate that has been transacted. The true swap rate for a fixed-for-floating swap is the fixed rate that will result in the swap having a net present value of zero at inception. This is generally the mid of the bid and ask swap rates quoted by a swap counterparty. The cost of entering into an interest rate swap is therefore generally 50% times the bid-ask spread quoted by the swap counterparty.

The entry cost is recognised at the time the interest rate swap is transacted, irrespective of when the swap matures and irrespective of whether the swap has a deferred start. For example, if an interest rate swap is entered into during the current financial year, with a two-year deferred start date and a term of five years, the entry cost is recorded in the current financial year.

Exit Cost: After an interest rate swap has been entered into, it can be either:

- held to maturity: in which case no exit cost is incurred. The total cost of the interest rate swap is therefore limited to the entry cost, which is generally 50% times the bid-ask spread and which was recognised at the time the interest rate swap was transacted; or
- terminated prior to maturity: in which case the exit cost is generally 50% times the bid-ask spread at the time of termination. The total cost of the interest rate swap is therefore generally 50% times the bid-ask spread recognised at the time the swap was transacted, plus 50% times the bid-ask spread at the time the swap is terminated. Upon termination, any mark-to-market gain or loss on the swap is realised and settled with the counterparty. This realised gain or loss is not recognised as an additional cost of the swap.

Since swap rates are usually quoted as a rate (or as basis points) per annum, the rate (or basis point) spread needs to be converted to a dollar cost. This can be done in one of two ways:

- the spread is multiplied by the PV01 of the swap. For example, if the bid-ask spread quoted by a counterparty for a 5-year Australian dollar interest rate swap with a notional of $10,000,000 is 3 basis points per annum (i.e. 0.03% pa), and the PV01 of the interest rate swap is \$4,755, then the entry cost of the interest rate swap recognised at the time it is transacted is:

50% x 3 basis points x \$4,755 = \$7,132.50

- the net present value of the swap is calculated at the bid rate as well as the ask rate. The sum of the two net present values is the cost of the swap. For the example above, the bid and ask net present values calculated by the trustee or responsible entity is:

NPVBid = -\$7,132.50

NPVAsk = -\$7,132.50

The total cost of the swap is the sum of the two net present values, which is -\$7,132.50 -\$7,132.50 = -\$14,265. The entry cost is 50% x -\$14,265 = -\$7,132.50. Note that the negative sign indicates that the amount is a cost to the trustee or responsible entity.

Inflation swaps

The cost of an inflation swap is calculated in the same manner as an interest rate swap. That is:

- the entry cost is generally 50% times the bid-ask spread quoted by the inflation swap counterparty; and
- the exit cost is generally either (i) if the swap is held to maturity, nil, or (ii) if the swap is terminated prior to maturity, 50% times the bid-ask spread quoted by the inflation swap counterparty.

Credit default swaps

The cost of a credit default swap is calculated in the same manner as an interest rate swap. That is:

- the entry cost is equal to 50% times the bid-ask spread quoted by the credit default swap counterparty; and
- the exit cost is equal to either (i) if the swap is held to maturity, nil, or (ii) if the swap is terminated prior to maturity, 50% times the bid-ask spread quoted by the credit default swap counterparty.

Credit default indices and credit default asset backed indices are treated in the same manner.

Forwards

The cost of a forward includes an assessment of the difference between the bid price and the ask price of the forward.

Entry cost: The cost of entering into a forward is generally the difference between the true forward price and the actual forward price transacted. The true forward price is generally the mid of the bid and ask forward price rates quoted by the derivative counterparty. The cost of entering into a forward is therefore generally 50% times the bid-ask spread quoted by the derivative counterparty.

The entry cost is recognised at the time the forward position is opened (whether it be a long position or a short position), irrespective of when the forward matures. For example, if a 1-month AUDUSD foreign exchange forward is entered into during the current financial year, but matures in the following financial year, the entry cost is recognised in the current financial year.

Exit Cost: Once a forward is entered into, it can be either:

- held to maturity: in which case no exit cost is incurred. The total cost of the forward is therefore limited to the entry cost, which is generally 50% times the bid-ask spread and which was recognised at the time the forward was transacted; or
- closed-out by entering into an offsetting transaction: in which case the cost of entering into the offsetting forward is generally 50% times the bid-ask spread at the time the offsetting forward is entered into. The total cost of the forward position is therefore generally 50% times the bid-ask spread recognised at the time the forward position was opened, plus 50% times the bid-ask spread recognised at the time the offsetting forward position was transacted.

Commonly traded total return swaps

The cost of a commonly traded total return swap includes an assessment of the difference between the bid rate and the ask rate of the swap.

Entry Cost: The cost of entering into a total return swap is generally the difference between the true total return swap rate and the actual total return swap rate that has been transacted. The true total return swap rate is generally the mid of the bid and ask total return swap rates quoted by the total return swap counterparty. The cost of entering into a total return swap is therefore generally 50% times the bid-ask spread quoted by the total return swap counterparty.

The entry cost is recognised at the time the total return swap is transacted, irrespective of when the total return swap matures.

Exit Cost: After a total return swap has been entered into, it can be either:

- held to maturity: in which case no exit cost is incurred. The total cost of the total return swap is therefore limited to the entry cost, which is generally 50% times the bid-ask spread and which was recognised at the time the total return swap was transacted; or
- terminated prior to maturity: in which case the exit cost is generally 50% times the bid-ask spread at the time of termination. The total cost of the total return swap is therefore generally 50% times the bid-ask spread recognised at the time the swap was transacted, plus 50% times the bid-ask spread at the time the swap is terminated. Upon termination, any mark-to-market gain or loss on the swap is realised and settled with the counterparty. This realised gain or loss is not recognised as an additional cost of the swap.

Since the difference in the bid and ask rate will usually be in basis points, the basis point spread will need to be converted to a dollar cost. This is done by calculating the net present value of the total return swap at the bid rate as well as the ask rate. The sum of the two net present values is the total cost of the total return swap.

For example, a total return swap counterparty provides the following quote for a 1-year total return swap on the MSCI All Country World TR Gross Index for a notional amount of USD 10,000,000:

Bid: 3-month LIBOR + 32 basis points

Ask: 3-month LIBOR + 41 basis points

The net present value of the total return swap calculated by the trustee or responsible entity is:

NPVBid = USD +32,175

NPVAsk = USD -41,225

The total cost of the total return swap is USD -41,225 + USD 32,175 = USD -9,050. The entry cost is generally 50% x USD -9,050 = USD -4,525. Note that the negative sign indicates that the amount is a cost to the trustees or responsible entity.

Bespoke total return swaps

Bespoke total return swaps, which may include specifically negotiated terms or features, are unlikely to have a cost assessment based on the difference between a bid rate and the ask rate of the swap. Instead the cost assessment is likely to be with consideration to the difference between how much the counterparty has to pay (or set off) and the value of the underlying reference asset of the swap.

Use of a minimum default amount

Where a trustee or responsible entity is unable to calculate the cost of an OTC derivative and the trustee or responsible entity believes that the OTC cost is not an amount that the trustee or responsible entity ought to know or which the trustee or responsible entity is able to reasonably estimate if it took reasonable steps, the trustee or responsible entity may apply a default amount based on the requirements of Schedule 10. Trustees and responsible entities should also have regard to ASIC's guidance in Regulatory Guide 97.

Calculating the actual return of an OTC derivative

In calculating the difference between the underlying return (which may be negative) on the asset or index that the trustee or responsible entity is gaining exposure to through the OTC derivative and the actual return or loss the trustee or responsible entity has received over the relevant period[21] the actual return of the OTC derivative is required to be determined with consideration to the return that has been or would be received (as applicable), or loss that would be payable during the period of the current financial year that the OTC derivative was held by the product. For example:[22]

- OTC derivative is entered in and exited in the current financial year: Actual return to be assessed from point of entering into the OTC derivative (with consideration to its actual enter value) to point of exiting the OTC derivative (with consideration to its actual exit value).
- OTC derivative is entered into in current financial year and held at year end: Actual return to be assessed from point of entering the OTC derivative (with consideration to its actual enter value) to 30 June (with consideration of the exit value of the OTC derivative as at 30 June).
- OTC derivative held at start of current financial year and exited during the current year: Actual return to be assessed from 1 July (with consideration to the exit value of the OTC derivative as at 30 June of previous financial year) to point of exiting the OTC derivative (with consideration to its actual exit value).
- OTC derivative held throughout the entire current financial year: Actual return to be assessed from 1 July (with consideration to the exit value of the OTC derivative as at 30 June of previous financial year) to 30 June (with consideration to the exit value of the OTC derivative as at 30 June).

The effect of the above requirement is that for all OTC derivatives the exit cost of the OTC derivative is recognised as a cost in the financial year the OTC derivative position is entered into, irrespective of whether the OTC derivative is held:

- over multiple financial years, in which case the exit cost of the OTC derivative is not realised until a future financial year; or
- held to maturity, in which case no exit cost is ever realised.

21 Refer to clause 101A(3)(a)(i) of Schedule 10 of the Corporations Regulations as inserted by ASIC Class Order 14/1252.

22 Refer to clause 101A(3A)(a)(i) of Schedule 10 of the Corporations Regulations as inserted by ASIC Class Order 14/1252.

With consideration to how OTC derivatives may be valued by a trustee or responsible entity on an ongoing basis, how OTC derivatives may be traded, including being held to maturity or closed-out before maturity by entering into an offsetting transaction and how such trades may be recorded in a trustee's or responsible entity's trading systems, recognition of OTC derivative returns and costs in accordance with the requirements of Class Order 14/1252 may be materially difficult for some trustee or responsible entity s in certain circumstances and may result in unreliable or inaccurate cost assessments being carried out.

It may therefore be appropriate for trustees and responsible entities to consider an alternative method of assessing OTC derivative returns and costs, where the trustee or responsible entity reasonably believes such alternative method of assessment is likely to result in a more accurate recognition of OTC derivative costs. Such alternative method may include recognising exit costs of an OTC derivative in the year in which the OTC derivative is actually exited.

Determination of bid-ask spreads of OTC derivatives

Many of the approaches outlined above for determining OTC derivative costs are based on the bid-ask spread of the OTC derivative. The bid-ask spread of an OTC derivative can be determined on an actual basis or they can be estimated, as follows:

- Actual: The actual bid and ask prices can be obtained from the OTC derivative counterparty at the time the derivative is transacted
- Estimate: Bid-ask spreads can be estimated from observed ***historical*** bid and ask prices, or they can be ***implied*** from current market data.

The following provides further guidance on estimating bid-ask spreads using historical prices and implying them from current data.

Historical bid-ask spreads

Generally, historical bid and ask prices are available for swaps and forwards. For total return swaps and OTC options, however, historical bid and ask prices will generally not be observable.

When downloading historical bid and ask prices from a data provider such as Bloomberg, the historical data may occasionally include erroneous data, for example a bid price that is generally the ask price; or bid and ask prices that result in an abnormally large spread; or bid and ask prices that result in a negative spread. Therefore, the data should be reviewed and any erroneous data should be corrected or excluded from the estimation of a bid-ask spreads.

One way of estimating the bid-ask spread for an OTC derivative is to:

- download the bid and ask prices for each day of the financial year;
- calculate the bid-ask spread for each day; and
- compute a simple average (after removing any erroneous data).

The table below presents a summary of the average historical spread for the financial year ending 30 June 2016 for a variety of United States interest rate swaps. It also includes the PV01 for a notional of USD 1,000,000 for each of these swaps, and the resulting entry cost of the swap in both dollars and as a percentage of notional.

USD Interest Rate Swaps

			Historical		Entry Cost		
Ccy	Notional	Term	BPS	PV01	$	%	Bloomberg Code
USD	1,000,000	1Y	0.32	99.91	15.99	0.0016%	USSW1 Curncy
USD	1,000,000	2Y	0.33	198.05	32.68	0.0033%	USSW2 Curncy
USD	1,000,000	3Y	0.28	295.14	41.32	0.0041%	USSW3 Curncy
USD	1,000,000	4Y	0.35	391.33	68.48	0.0068%	USSW4 Curncy
USD	1,000,000	5Y	0.31	486.22	75.36	0.0075%	USSW5 Curncy
USD	1,000,000	7Y	0.27	672.07	90.73	0.0091%	USSW7 Curncy
USD	1,000,000	10Y	0.30	937.28	140.59	0.0141%	USSW10 Curncy
USD	1,000,000	15Y	0.28	1,345.69	188.40	0.0188%	USSW15 Curncy
USD	1,000,000	30Y	0.23	2,340.86	269.20	0.0269%	USSW30 Curncy

For example, the historical average spread for the 5-year United States interest rate swap is 0.31 basis points, and the PV01 (for a notional of USD 1,000,000) is USD 486.22. The entry cost of the swap is therefore able to be estimated as:

50% x 0.31 x USD 486.22 = USD 75.36

The entry cost, expressed as a percentage of notional is able to be estimated as:

USD 75.36 ÷ USD 1,000,000 = 0.0075%

To estimate the cost of a 5-year United States interest rate swap for a different notional amount, the cost expressed as a percentage of notional can be utilised. For example, for a 5-year United States interest rate swap for a notional of USD 25,000,000, the estimated cost is:

0.0075% x USD 25,000,000 = USD 1,875

Implied bid-ask spreads

Where historical data is not observable (for example for total return swaps and OTC options), the bid and ask prices can be implied from market data using a relevant derivative pricing model.

The table below presents the bid and ask premiums for vanilla at-the-money EURUSD call options for an amount of EUR 1,000,000 and a maturity of 1-month, 2-months, 3-months and 6-months. The Bloomberg OVML function can be utilised to compute the bid and ask premiums.

Vanilla ATM Forward

Ccy	Amount	Ccy	Term	P/C	Ccy	Bid Premium €	Ask Premium €	Ccy	Bid Premium %	Ask Premium %	Spread €	Spread %
EURUSD	1,000,000	EUR	1M	Call	EUR	10,456	10,931	EUR	1.0456%	1.0931%	475	0.0475%
EURUSD	1,000,000	EUR	2M	Call	EUR	14,756	15,373	EUR	1.4756%	1.5373%	618	0.0618%
EURUSD	1,000,000	EUR	3M	Call	EUR	19,681	20,691	EUR	1.9681%	2.0691%	1,010	0.1010%
EURUSD	1,000,000	EUR	6M	Call	EUR	28,102	29,953	EUR	2.8102%	2.9953%	1,851	0.1851%

For example, at the date of calculation, the bid and ask premiums for a vanilla 3-month at-the-money EURUSD call option were EUR 19,681 and EUR 20,691 respectively. The bid-ask spread is:

EUR 20,691 - EUR 19,681 = EUR 1,010

Expressed as a percentage, the bid-ask spread is:

EUR 1,010 ÷ EUR 1,000,000 = 0.1010%

Where a derivative is denominated in a foreign currency (for example, the United States interest rate swap and EURUSD currency option examples above), the bid-ask spread will generally also be denominated in the foreign currency. To calculate the Australian dollar derivative cost, the relevant spot foreign exchange rate should be applied to the bid-ask spread at the time the foreign currency denominated derivative is executed.

6.8 Rebates and other reductions in fees and costs

The general premise of fee and cost disclosure is that amounts that reduce the value of an investment or the return to members should be disclosed. Rebates, offsets and similar arrangements increase the return to members by reducing the fee and cost burden in the financial year to which they relate and may be deducted from any management or other fees and costs. The IWG recommends disclosure of fees and costs net of these amounts.

6.9 Application to private equity investments

It is common for private equity providers of direct investments (general partners or GPs) to provide services to investee entities (the underlying operating entities) and be paid remuneration or have their expenses reimbursed. These amounts might include director fees, fees for services provided to the entity, provision of staff to the investee and investment banking or underwriting fees. GPs are nearly always paid on an *arm's length basis* amounts that the investee entity would otherwise pay to other third parties (but commercially it makes sense for the GP to provide those services due to its familiarity with the business).

The reason these amounts are paid to the GP outside of any fee that the GP is entitled to from the fund is often because they are for services to the investee entity that are beyond its role as a manager of the fund (e.g. underwriting, the supply of personnel, consulting and investment banking services). For example, in private equity a GP may provide a chief financial officer to an investee entity. This is a role the company would ordinarily pay for in its ordinary course of business and therefore the amount paid to the GP for providing the chief financial officer is not an amount that reduces returns to members in that company. This represents an ordinary operating expense of the investee entity, conducted on an arms' length basis, which should not be required to be disclosed.

These amounts do not reduce the value of the investee or the return to the fund provided they are bona fide ordinary operating expenses of the investee's business.

Where a GP contributes its own capital for an interest in the fund, any returns paid to the GP as a result of its interest are not costs to be included under the fees and costs disclosure regime provided it has paid an arm’s-length price for its interest.

<u>Example</u>: If a GP rebates a portion of the management fee payable by a member by the amount of the chief financial officer’s salary or other investee-related expenses, a trustee or responsible entity investing in the private equity fund may reduce their management fee with the rebate e.g. of 2% may be reduced to 1.9% following the rebate.

The costs of the investee businesses do not need to be included in fee and cost disclosure provided the costs are paid for at arm’s length. This includes:

- The costs of issuing shares in any special purpose vehicles to the PE fund operator.
- The costs of listing the investee business on a financial market.
- The cost of remuneration of staff and directors of the SPC after it acquires the business to the extent that the remuneration is in relation to the operation of the SPC and its business.

However, the following costs need to be included:

- The costs of establishing any special purpose vehicles (organisational expenses).
- Any other costs in relation to the special purpose vehicle incurred before it acquires investee companies.
- The costs relating to the acquisition of shares by the private equity fund (e.g. legal costs), even if these costs are met by the special purpose vehicle.
- The costs of the provision of associated finance provided by the private equity fund.

6.10 Attributing costs of interposed vehicles

There is significant complexity in determining what fees and costs of an interposed vehicle should be attributed to the superannuation product or managed fund. The following principles should be adopted when undertaking indirect cost calculations:

- fees and costs of an interposed vehicle should not be offset by income of the superannuation fund
- fees and costs of an interposed vehicle should not be offset by income of another superannuation fund
- to avoid double counting, costs can be offset by amounts generated from other costs – for example, to the extent that transaction costs are recovered eg via the buy/sell spread, they are not required to be disclosed.

6.11 Internal processes and policy documentation

There is no express legal obligation to set out fees and costs disclosure compliance in a policy or process documentation. However, doing so will assist in a trustee or responsible entity in satisfying the legal defence of taking reasonable steps to ensure that a PDS is not defective. Accordingly, the IWG recommends that a trustee or responsible entity prepare and maintain the following:

- a positions document which outlines the legal positions the trustee or responsible entity has adopted on different aspects of the fees and costs disclosure regime;
- either a separate board approved fees and costs due diligence policy, or expand the board approved disclosure document due diligence policy for the fees and costs disclosure regime; and
- a procedures document which outlines the how the trustee or responsible entity will obtain fees and costs information and when it will do so, and how to make reasonable estimates when it cannot obtain that information.

Ideally, these documents should be independently reviewed at the time of establishment, then at least every three years and whenever regulation or fees and costs are materially changed.

ASIC encourages the publication of abridged versions of these documents on websites.

7 DISCLOSURE OF FEES AND COSTS IN PDS

7.1 Main fee table

For superannuation products, Schedules 10 and 10D of the Corporations Regulations require disclosure in table form of the following:

- investment fees;
- administration fees;
- buy/sell spreads;
- switching fees;
- exit fees;
- intra-fund advice fees;
- other fees and costs; and
- indirect cost ratio.

For 8 page PDSs for superannuation products, the trustee should:

- disclose the fees and costs for one investment option (eg MySuper product) in the 8 page PDS using the table set out in Schedule 10D following the instructions in that Schedule; and
- disclose the fees and costs for all investment options in an incorporated document using the table set out in Schedule 10 following the instructions in that Schedule.

For long form PDSs for superannuation products, the trustee should disclose the fees and costs for all investment options using the table set out in Schedule 10 following the instructions in that Schedule.

Investment fees are normally disclosed on a percentage per annum basis, and may be disclosed as separate components. Administration fees may be disclosed as either a dollar amount per period (eg per week or per month), a percentage per annum or a combination of the two. The indirect cost ratio must be disclosed on a percentage per annum basis.

For managed funds, Schedule 10E requires disclosure in table form of the following:

- establishment fee;
- contribution fee;
- withdrawal fee;
- exit fee; and
- management costs,

and Schedule 10 requires the disclosure of the above amounts plus switching fees.

For 8 page PDSs for a simple managed investment scheme:

- with no investment options (and which is not a multi-fund PDS), the responsible entity should disclose the fees and costs for the managed fund in the 8 page PDS using the table set out in Schedule 10E following the instructions set out in that Schedule. It is not common for such PDSs to include the table set out in Schedule 10 in an incorporated document; and
- with investment options, the responsible entity should disclose the fees and costs for a single investment option in the 8 page PDS using the set out in Schedule 10E following the instructions set out in that Schedule, and to disclose the fees and costs for all investment options in an incorporated document using the table set out in Schedule 10 following the instructions in that Schedule.

For long form PDSs for managed funds (eg hedge funds PDS, multi-fund PDSs), the responsible entity should disclose the fees and costs for all managed funds using the table set out in Schedule 10 and following the instructions in that Schedule.

In a long form PDS, a trustee or responsible entity should include information on each of the fees and costs (eg for superannuation funds, investment fees, administration fees, buy/sell spreads and indirect cost ratio; or for managed funds, management costs). It is open to a trustee or responsible entity to include all this information in the main fees and costs table or to include a range in the fees and costs table together with a reference to a second table which sets out this information (clause 205 of Schedule 10). When using a shorter PDS, the table must be based on the MySuper or balanced option (as appropriate) as set out in Schedule 10D for superannuation products and Schedule 10E for managed funds, and information about other options in the PDS (including by incorporation by reference).

A statement with information about past experience has a greater risk of being misleading or deceptive if it is presented in a manner that implies it constitutes a projection illustrating the likely future value of the amount or in a way that creates the impression that substantially the same amounts will be incurred in the future. Accordingly, if a trustee or responsible entity believes that there is a risk that costs information disclosed in a PDS calculated retrospectively may change in the future, it should clarify which amounts are calculated retrospectively using terminology such as “Estimated to be XX % pa for the 12 months to 30 June 20XX” under “Additional Explanation of Fees and Costs”.

A statement with information about past experience also has a greater risk of being misleading or deceptive unless it draws attention (unambiguously and without reservation) to the fact that the past experience will not necessarily be repeated. ASIC’s position is that only the required information can be included in the main fees and costs table (except in limited circumstances) and it considers that the law prohibits the inclusion of a warning in the main fees and costs table. However, for costs that may materially change in the future, to help reduce the risk of being misleading or deceptive, a trustee or responsible entity should include a warning in the Additional Explanation of Fees and Costs, such as “Past costs are not a reliable indicator of future costs”.

7.2 Additional Explanation of Fees and Costs

Clause 209 of Schedule 10 requires the following information to be included in the Additional Explanation of Fees and Costs:

- information on performance fees, including the amount of the fees or an estimate of the amount if the amount is not known;
- details of transaction costs, such as brokerage and buy/sell spreads, including the amount or an estimate of the amount if the amount is not known; and
- for superannuation products only, details of borrowing costs, including a description of the cost and the amount or an estimate of the amount if the amount is not known; and
- for superannuation products only until 30 September 2018, details of property operating costs, including a description of the cost and the amount or an estimate of the amount if the amount is not known.

SEE ASIC QUESTIONS AND ANSWERS 15 TO 17, 24

FEES AND COSTS DISCLOSURE

The IWG recommends to:

- disclose amounts of performance fees / performance-related fees as a ratio for the investment option or product, calculated on the same basis as the indirect cost ratio;
- disclose total amounts of transaction costs (including any transaction costs of interposed vehicles) as a ratio for the investment option or product, calculated on the same basis as an indirect cost ratio;

- disclose amounts of borrowing costs and property operating costs as a ratio for the investment option or product, calculated on the same basis as an indirect cost ratio;
- identify amounts which are calculated retrospectively using terminology such as “Estimated to be XX % pa for the 12 months to 30 June 20XX”; and
- where there is a risk of costs materially changing in the future, include a warning such as “Past costs are not a reliable indicator of future costs”.

The following table is provided by way of example to show possible disclosures in the Additional Explanation of Fees and Costs for a superannuation product with multiple investment options where:

- a dollar based administration fee is deducted from the member account and a percentage-based administration fee is deducted from fund assets
- a buy/sell spread applies to each investment option
- the trustee has not elected to disclose performance-related fees or transactional and operational costs as part of the indirect cost ratio.

Appropriate adjustments should be made to the table where a trustee has different fee arrangements and has made different elections. For example, additional columns may be required where a trustee elects to disclose amounts as part of the indirect cost ratio.

Table 1: Detailed table of investment option fees and costs for a superannuation product

Investment option	(A) Administration fees	(B) Estimated investment fees (excluding performance-related fees) for 12 months to 30 June XX	(C) Estimated performance-related fees for 12 months to 30 June XX	(D) Estimated indirect costs for 12 months to 30 June XX	(A) + (B) + (C) + (D) Total	Buy/sell spread
XYZ investment option	0.20% pa	0.89% pa	0.06% pa	0.34% pa	1.49% pa	0.12% of transaction amount
ABC investment option	0.20% pa	0.21% pa	0.05% pa	0.12% pa	0.46% pa	0.11% of transaction amount

Note: Past costs are not a reliable indicator of future costs.

The following tables are provided by way of example to show possible disclosures in the Additional Explanation of Fees and Costs for a managed fund.

Table 2a: Detailed table of management costs for a managed fund (with a performance-related fee)

Investment option	Management fee	Estimated performance fees	Estimated indirect costs for 12 months to 30 June 20XX (recoverable expenses)	Estimated Performance-Related Fees for 12 months to 30 June 20XX	Estimated Other Indirect Costs for 12 months to 30 June 20XX
XYZ investment option	0.58% pa	0.06% pa	0.14% pa	1.01% pa	0.12%
ABC investment option	0.30% pa	0.05% pa	0.12% pa	0.46% pa	0.11%

Note: Past costs are not a reliable indicator of future costs.

Table 2b: Detailed table of management costs for a managed fund (with no performance-related fees)

Investment option	Management fee	Estimated indirect costs for 12 months to 30 June 20XX (recoverable expenses)	Estimated Performance-Related Fees for 12 months to 30 June 20XX	Estimated Other Indirect Costs for 12 months to 30 June 20XX
XYZ investment option	0.58% pa	0.14% pa	1.01% pa	0.12%
ABC investment option	0.30% pa	0.12% pa	0.46% pa	0.11%

Note: Past costs are not a reliable indicator of future costs.

7.3 Disclosure of transactional and operational costs

Refer to section 4.9 for explanatory information on transactional and operational costs. Refer to section 6.6 for information on the calculation of transactional and operational costs.

Trustees and responsible entities are required to disclose all transactional and operational costs incurred by the superannuation product or managed fund, including those attributable to member applications and redemptions, which may be recovered (in whole or in part) through an investment option's or product's buy-sell spread (or other method of transaction cost recovery). The different methods by which transactional and operational costs are passed onto members will have different consequences from a disclosure perspective. The disclosure and apportionment of transactional and operational costs also differs for superannuation products and managed funds.

Given the different treatment of transactional and operational costs by managed funds and superannuation products, responsible entities may choose to separately disclose explicit transaction costs, implicit transaction costs, property operating costs and bid-ask spreads of OTC derivatives in PDSs. In the absence of detailed product disclosure, responsible entities may be required to provide trustees with detailed transaction cost reporting, including the relevant sub-components of transaction costs, to facilitate the trustee to complete its own Regulatory Guide 97 compliant product disclosures.

Where the buy-sell spread recovery exceeds the total transactional and operational costs, the amount in the "net costs" row should be disclosed as nil.

Trustees and responsible entities may choose to provide additional disclosure further explaining why the transaction cost recovery exceeds total transaction costs and how this effects a product's performance.

In determining how best to disclose transaction costs in a PDS and in order to aid member understanding, a trustee or responsible entity may want to have regard to the disclosure of the same costs in any periodic or exit statement (or any other member disclosure) and may want to apply a consistent method of disclosure across each method of member disclosure.

The following table summarises the breakdown of the various transactional and operational costs and how they need to be disclosed in a PDS of a managed fund and superannuation product:

	Managed fund	**Superannuation product**	
	Are transactional and operational costs a required component of the fee/cost disclosure? [23]		**Notes**
Fees and costs table			
Buy-sell spread	No	Yes	For superannuation products, the buy-sell spread is a per transaction fee, applied to members transacting with the product or investment option. For managed funds, while the buy-sell spread is not disclosed in the fees and costs table, buy-sell spread disclosure is required under the Additional Explanation of Fees and Costs section of the PDS.
Investment fee or indirect cost ratio *(only applicable to superannuation products)*	NA	Explicit transaction costs	Superannuation products required to disclose all explicit transaction costs as either an investment fee or indirect cost ratio, excluding those costs recovered from the investment option's buy/sell spread.
Management costs (*only applicable to managed funds*)	No	NA	Transactional and operational costs are excluded from the management costs of managed funds.

23 While the transaction costs may be a required component of the aggregated fee/cost disclosure this does not necessarily mean the transaction costs need to be separately disclosed, with just the single aggregated fee/cost amount being disclosed in many instances.

Additional Explanation of Fees and Costs [24]			
Transactional and operational costs[25]			
▪ Explicit costs	Yes	Yes	For example clause 103 of Schedule 10 transactional and operational costs.
▪ Implicit costs	Yes	Yes	Bid-ask spread assessment on all asset classes (excluding OTC derivative transaction costs).
▪ **OTC derivative costs**	Yes	No	Where an OTC derivative cost is in the nature of a transactional and operational costs (see section 4.9 for further information), managed funds must disclose the amount as transactional and operational costs. In practice, the IWG believes that most OTC derivative costs are in the nature of transactional and operational costs. Superannuation products must not disclose any OTC derivative cost as part of their transactional and operational costs. See section 7.4 for more information on the disclosure of OTC derivative costs.
Transaction cost recovery	Yes	Yes	Value of transaction costs recovered through the application of any transaction cost recovery (i.e. buy-sell spread).
Net transactional and operational costs	Yes	Yes	Total transaction costs minus transaction cost recovery.
Buy/Sell Spread	Yes	Yes	Per transaction fee to applied to members transacting with the product, to include an explanation of how this fee is determined.

Superannuation products

Superannuation products must disclose all the costs of investing in their investment fee or indirect cost ratio. This includes certain components of transactional and operational costs, as outlined below

In addition to their inclusion in investment fees or indirect cost ratio, trustees must also separately disclose details of all transactional and operational costs, other than OTC derivative costs, in the Additional Explanation of Fees and Costs section of the PDS.

This means that all explicit transaction costs must be included in the investment fee or indirect cost ratio, as well as being included in the Additional Explanation of Fees and Costs.

Implicit transaction costs, excluding OTC derivative costs, are not regarded as a component of a superannuation product's investment fee or indirect cost ratio, as they are a cost of the assets of the product, not a cost relating to those assets. Implicit transaction costs, excluding OTC derivative costs, are therefore excluded from a superannuation product's calculation of investment fees or indirect cost ratio. Implicit transaction costs are, however, still a transactional and operational cost and must therefore be disclosed in the Additional Explanation of Fees and Costs section of the PDS.

As the buy-sell spread of a superannuation product is considered a fee, explicit transaction costs recovered as a result of an applied buy-sell spread are excluded from the superannuation product's calculation of its investment fees and indirect costs.

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24 Clause 209(j) of Schedule 10, disclosure to include a description of the fee or cost and the amount or an estimate if the amount is not known.

25 Trustees and responsible entities may choose to disclose transaction costs on a total basis (i.e. including explicit, implicit and OTC derivative transaction costs) or on a per transaction cost component basis.

Property operating costs must be disclosed if they are incurred by the superannuation product or by an interposed vehicle. Property operating costs incurred by an entity that is not an interposed vehicle do not need to be disclosed.

For a superannuation product, prior to 30 September 2018, property operating costs are not required to be disclosed as part of the investment fee / indirect cost ratio or transactional and operational costs if details of the property operating costs are included in the Additional Explanation of Fees and Costs section of the PDS. From 30 September 2018 onwards, property operating costs are required to be disclosed in either the investment fee or the indirect cost ratio, and as transactional and operational costs, provided that the cost is incurred either directly by the superannuation product or by an interposed entity.

The disclosure of OTC derivative costs by trustees is discussed in section 7.4.

Table 3: Table of transactional and operational costs, borrowing costs and property operating costs for a superannuation product

The following table provides an example of how transactional and operational costs can be disclosed in the transactional and operational costs section in the Additional Explanation of Fees and Costs for a superannuation product (based on the example outlined in section 7.2):

Investment option	**(A) Estimated gross transactional and operational costs for 12 months to 30 June 20XX**	**(B) Estimated transactional and operational costs recovered from buy/sell spread for 12 months to 30 June 20XX**	**(C = A - B) Estimated transactional and operational costs affecting returns[26]**	**(D) Estimated transactional and operational costs included investment fee**	**(E = C - D) Estimated transactional and operational costs not included in investment fee**	***Estimated borrowing costs not included in investment fee for 12 months to 30 June 20XX[27]***	***Estimated property operating costs not included in the investment fee for 12 months to 30 June 20XX[28]***
XYZ investment option	2.00% pa	0.40% pa	1.60% pa	0.20% pa	1.40% pa	*0.40% pa*	*0.15% pa*

Note: Past costs are not a reliable indicator of future costs.

Managed funds

Transactional and operational costs, whether incurred directly or through an interposed vehicle do not form part of management costs[29].

26 If satisfied that the term is not misleading or deceptive, a trustee or responsible entity may wish to consider using the term "transaction costs" rather than "transactional and operational costs".

27 It is open to trustees to disclose borrowing costs in a separate table in the borrowing costs section of the Additional Explanation of Fees and Costs.

28 Relevant to PDSs for superannuation products until 30 September 2018.

29 Refer to clause 102(2) of Schedule 10 Corporations Regulations.

Information on transactional and operational costs (including the amounts of transactional and operational costs and the amounts of buy/sell spreads) are, however, required to be disclosed in the Additional Explanation of Fees and Costs section of the PDS[30].

As a result, explicit transaction costs and implicit transaction costs must be disclosed as part of the amount of transactional and operational costs set out in the Additional Explanation of Fees and Costs. Property operating costs must also be included in this amount, noting that managed funds have no transitional period and are currently required to disclose such amounts.

The disclosure of OTC derivative costs by responsible entities is discussed in section 7.4.

Table 4: Detailed table of transaction costs for a managed fund

The following table provides an example of how transactional and operational costs can be disclosed in the transaction costs section in the Additional Explanation of Fees and Costs for a managed fund (based on the example outlined in section 7.2). The estimated transactional and operational costs are shown as a percentage of the average net assets of the fund:

Estimated gross transactional and operational costs for 12 months to 30 June 20XX[25]	0.40%
Transactional and operational costs offset by buy/sell spreads for 12 months to 30 June 20XX	0.20%
Estimated net transactional and operational costs borne by the Fund	0.20%

Note: Past costs are not a reliable indicator of future costs.

Based on ASIC's example of the calculation of transactional and operational costs in RG97 Fees and Costs Question 15, the PDS will need to state under 'Additional Explanation of Fees and Costs' that of this 2%, the trustee recouped a portion as a buy–sell spread payable by incoming members in Superannuation Fund X and the remaining amount has been reflected in reduced returns to the superannuation fund members. We encourage trustees to quantify the amount that was recouped in the relevant financial year as buy–sell spread (i.e. that of the 2% transaction costs, 0.4% was recovered as buy–sell spread and 1.6% reduced the returns of the fund).

Fund Y transaction costs			
	Gross	Recovery	Net
Explicit	2.00%	0.80%	1.20%
Implicit Costs (Bid-ask spread)	0.50%	0.20%	0.30%
Total	2.50%	1.00%	1.50%

30 Refer to clause 209(j) of Schedule 10 Corporations Regulations.

Superannuation Fund X disclosures

Item	Fee or cost description	Amount	Calculation	Disclosure required
Fee table disclosures				
	Investment fee or indirect costs			
A	Fund Y management fee	1.00%		
B	Fund Y net explicit costs	1.20%		
C	Superannuation Fund X net explicit costs	0.10%	F- I	
D	**Total (to be disclosed as an investment fee or indirect costs)**	**2.30%**	A + B + C	Yes
	Buy-sell spread of Superannuation Fund X	0.40%/0.40%		Yes
Additional Explanation of Fees and Costs disclosures				
	Transaction costs			
E	Fund Y total net transaction costs (includes explicit and implicit costs)	1.50%		
F	Superannuation Fund X explicit costs (buy-sell spread of Fund Y)	0.50%	$1m x 0.50%	
G	**Total transaction costs**	**2.00%**	E + F	Yes
I	**Transaction cost recovery (Superannuation Fund X buy-sell spread)**	0.40%	$1m x 0.40%	Yes
J	**Net transaction costs**	**1.60%**	G - I	Yes
	Buy-sell spread			Yes
	Reconciliation			
L	Fund Y net implicit costs not included in Indirect Costs	0.30%		
M	Transaction costs included in Indirect Costs	1.30%	J - L = B + C	

7.4 Disclosure of OTC derivative costs

While the placement of OTC derivative cost disclosures differs between managed funds and superannuation products, the overall disclosure of such costs is harmonious between both product types.

SEE ASIC QUESTIONS AND ANSWERS 19 TO 21

FEES AND COSTS DISCLOSURE

Managed funds

OTC derivative costs are in the first instance required to be disclosed as a management cost, allocated to the product's indirect costs. Responsible entities are, however, permitted to classify OTC derivative costs as transaction costs in the following circumstances, thereby removing such costs from the product's management cost disclosure:

- where the OTC derivative is acquired primarily for hedging, the entire cost of the OTC derivative may be classified as a transaction cost; and

- where the OTC derivative is acquired for other purposes, the assumed transaction costs that would arise in holding the ultimate reference asset or in replicating the OTC derivative's economic outcome may be classified as a transaction cost.

OTC derivatives are generally held by managed funds as they are more cost effective than holding the ultimate reference asset or more cost effective than replicating the same economic outcome of the OTC derivative. Accordingly, in many instances a managed fund may be expected to disclose all OTC derivative costs as transactional and operational costs. Responsible entities should, however, test this general assumption in determined how to properly apportion OTC derivative costs between management costs and transactional and operational costs.

Superannuation products

OTC derivative costs are required to be disclosed as part of either:

- an investment fee, where the OTC derivative is held directly by the superannuation product or where the OTC derivative is held through an interposed vehicle and the trustee has not elected to treat such costs as part of the indirect cost ratio; or
- indirect cost ratio, where the OTC derivative is held through an interposed vehicle and the trustee has elected to treat such costs as part of the indirect cost ratio.

Unlike managed funds, superannuation products are not permitted to classify OTC derivative costs as transactional and operational costs. Superannuation products are, however, not required to disclose any OTC derivative costs as transactional and operational costs.

7.5 Disclosure of performance fees and performance-related fees

Refer to section 6.5 for information on the calculation of performance fees and performance-related fees.

A trustee should include performance fees and performance-related fees as an investment fee of a superannuation product, unless incurred by an interposed vehicle and the trustee has elected to disclose the amount as an indirect cost ratio.

A responsible entity should include performance fees and performance-related fees as management costs of a managed fund. ASIC's view is that responsible entities should disclose:

- performance fees in the main fee table on a prospective basis;
- performance fees in the Additional Explanation of Fees and Costs on a prospective basis; and
- performance fees charged directly to members' accounts in the statutory fee example on a prospective basis, and all other performance fees on a historical basis.

For performance-related fees paid by a superannuation fund or managed fund, and not payable to the trustee or responsible entity, it is the amount actually incurred last financial year (except for new funds) that will form part of the amount that is disclosed.

However, the Additional Explanation of Fees and Costs must set out information on performance fees including:

- a statement about how performance fees affect administration fees and investment fees for the superannuation product
- the method for calculating the fees, and
- an estimate of the fees.

The IWG recommends that the Additional Explanation of Fees and Costs also include similar information on all performance-related fees.

The statutory fee example must also include estimates of performance fees and performance-related fees.

Where a trustee or responsible entity considers that inclusion of performance fees calculated on a retrospective basis would result in the PDS being misleading or deceptive, it should still include the amount calculated retrospectively but should consider what other information to include in the document to reduce the risk of being misleading or deceptive.

7.6 Disclosure of carried interest

Carried interest (or "carry") is common in limited partnership structures for private equity and hedge funds. It generally involves a share of the profits of an investment paid to the general partner in excess of the amount that reflects its financial contribution to the partnership.

Economically, carried interest has a similar purpose to performance fees being to reward the general partner for enhancing performance.

Trustees and responsible entities should disclose carried interest in the same manner as performance fees.

7.7 Disclosure of levies

(Superannuation only)

Some superannuation funds charge a levy against members to recoup costs incurred in operating the fund - for example, to cover the cost of APRA levies, the cost of implementing regulatory reforms, or to recoup expenses such as audit fees.

The levies may be calculated as a static 'basis points' value, or by reference to the actual costs incurred. In labelling any levy, care should be taken that the amount to be recovered is limited to the purpose implied by the label. Once quantified, the amount may be charged directly against member accounts, or recouped via an adjustment to unit prices for investment funds.

Where the costs that are recouped by way of the levy are paid out of the relevant superannuation product they would meet the definition of administration fees, and should be disclosed as such.

If the costs are not paid out of the relevant superannuation product and are passed on in a way that reduces the returns experienced by the fund member, the costs can be disclosed as administration fees, or in accordance with Regulatory Guide 97 may be treated as investment fees or, if the superannuation fund trustee has elected in writing to treat those costs as indirect costs, the indirect cost ratio.

7.8 Disclosure of borrowing costs

Refer to section 4.8 for explanatory information on borrowing costs.

For superannuation products, borrowing costs (whether of the superannuation fund or interposed vehicle) should not be included in the main fees and costs table (unless they are operational borrowing costs forming part of transactional and operational costs included in indirect costs), however, the Additional Explanation of Fees and Costs must separately include details of borrowing costs, including amounts of borrowing costs. This disclosure should be based on a product's or option's net asset value (NAV). A trustee may choose to also disclose borrowing costs based on a product's or option's gross asset value (GAV).

For managed funds, borrowing costs (whether of the fund or interposed vehicle) should not be included in the main fees and costs table, however, the IWG recommends that the Additional Explanation of Fees and Costs separately include details of borrowing costs, including amounts of borrowing costs. This disclosure should be based on a fund's NAV. A responsible entity may choose to also disclose borrowing costs based on a fund's GAV but should clearly state this (given that lower amounts are disclosed where based on GAV).

8 UPDATING PRODUCT DISCLOSURE STATEMENTS

8.1 Materiality of changes in PDS

The concept of materiality is relevant to a variety of contexts for PDS disclosure. Materiality will impact:

- the situations when a PDS update can be used to update the fees and costs information in a PDS: A PDS must be up-to-date at all times. However, if the updated information is not materially adverse information, it is open to a trustee or responsible entity to update the PDS through a PDS update: ASIC Corporations (Updated Product Disclosure Statements) Instrument 2016/1055;
- the situations in which remedial action must be taken in relation to a defective PDS: Remedial action must be taken if a PDS is defective. A PDS will be "defective" if it contains a misleading or deceptive statement which is materially adverse to a retail client: section 1016D;
- the situations in which a significant event notice ("SEN") must be issued: A trustee or responsible entity is only required to notify members of material changes to a matter, and significant events that affect a matter set out in the PDS: section 1017B; and
- for managed funds, the situations in which continuous disclosure is required: sections 674 and 675.

Context is relevant in determining materiality for each of these requirements and the factors in making the assessment for this determination will vary accordingly.

This guide focusses on the factors for situation (a), although it may also be relevant to the other situations, as well as determining reasonable steps for the purposes of forming estimates of indirect costs.

In addition, a determination of these issues requires a separate assessment of whether the change is material and whether the change is adverse. These are assessed separately below.

8.2 Background considerations to guide a determination

The PDS disclosure rules require that a PDS be "clear, concise and effective" (section 1013D(3)) and that the PDS be kept up-to-date (section 1012J). It is also noted that:

- the intent and purpose of ASIC Corporations (Updated Product Disclosure Statements) Instrument 2016/1055 is to ensure that where a PDS does not contain the most current information available at the time it is given to members, even though it was up to date when it was prepared, enables a trustee or responsible entity to avoid the expense and inconvenience of continually replacing PDSs or preparing successive supplementary PDSs (see ASIC Consultation Paper 255);
- the intent and purpose of RG 221 *Facilitating digital financial services disclosure*, is to make disclosure more effective and efficient by encouraging and facilitating the use of digital disclosure. Financial services disclosures are often lengthy, printed documents that many clients find difficult to understand and engage with. An advantage of digital disclosure for clients is that it can incorporate more engaging forms of media and can be interactive. This can make the information more attractive and easier to understand for clients. It can also be more timely, convenient and reliable;
- the cost component of investment fees / indirect cost ratio and management costs must be based on amount in the financial year before the PDS is issued ("Year 0"). Accordingly, a PDS could become out of date if a trustee or responsible entity subsequently obtains updated information pertaining to Year 0 amounts. The PDS will not become out-of-date because of information obtained on the costs for Year 1, but it may become misleading or deceptive; and
- a SEN must be issued for any material increase in fees and costs, however, the 30 day prior notice is only required for increases in the fee component of an amount disclosed in a PDS. The trustee or responsible entity has up to 3 months to notify of increases on the cost component of a disclosed amount.

8.3 When is a change material – what are the factors?

The change must be considered from a member perspective.

Some of the factors that may be relevant to the assessment of materiality are outlined below.

8.4 Quantum

For an increase in amount, is the increase proportionately significant? That is, the relative size of the change is to be considered.

GOOD PRACTICE

While not determinative of itself and the above factors must also be considered in conjunction with the below, it is recommended that a "10 and 10" rule be adopted as an approximate guide, as follows:

- for superannuation products, the greater of:
  - (i) 10bps: where the total of the investment fee, administration fee and indirect cost ratio ("Total Fee") increases by 0.10% or more – for example, an increase in the Total Fee from 0.40% pa to 0.50% pa; or
  - (ii) 10%: where there is a 10% or more increase in the Total Fee – for example, an increase in the Total Fee from 0.40% pa to 0.44% pa; and
- for managed funds, the greater of:
  - (i) 10bps: where the total management costs increases by 0.10% or more – for example, an increase in the total management costs from 0.40% pa to 0.50% pa; or
  - (ii) 10%: where there is a 10% or more increase in the total management costs – for example, an increase in the total management costs from 0.40% pa to 0.44% pa.

Where administration fees or management costs include a dollar-based amount, the dollar-based amount should be converted to a percentage amount based on a $50,000 balance (consistent with the statutory fee example).

This does not mean that increases of less (or more) than these amounts will automatically be immaterial (or material). However, it does mean that the circumstances should be considered in greater detail to determine whether or not the increase is or is not material. In particular, the introduction of a new fee or costs is likely to be considered material.

8.5 PDS disclosure

Does the PDS have relevant disclosure explaining relevant matters, including:

- that the fee or cost may change / potential fluctuations
- where up-to-date information may be found.

8.6 Nature of the amount

Is it a fee or a cost? For these purposes, a "fee" is an amount charged by the trustee or responsible entity.

Does it impact the management cost or investment fee / indirect cost ratio (and, accordingly, the statutory fee example) or only transactional and operational costs (in the Additional Explanation of Fees and Costs)? If it impacts the statutory fee example, it is more likely to be material.

It is important to remember that the above materiality threshold is limited to determining whether changes in the main fee and cost table are material (ie the "above-the-line" amounts). It is not appropriate to apply these thresholds to other amounts disclosed in a PDS (ie. the "below-the-line" amounts).

In practice, this means that for superannuation products, the thresholds could not be applied to determine the materiality of changes to implicit transaction costs or borrowing costs and for managed funds, the thresholds could not be applied to determine the materiality of changes to transaction costs.

8.7 Timing

Having regard to the nature of the change, is the change likely to be an ongoing one or an abnormal change only for a particular financial year?

8.8 When is a change adverse – what are the factors?

Is a recalculation due to new regulatory requirements? If there is no change other than because of different regulations this is less likely to be a materially adverse change.

Similarly, if there is no change in methodology, but the change results from applying the methodology, then it is unlikely to be materially adverse and the change can be updated online. An example of this is performance fees. The FSC Guidance Note states that any increase in performance fees / performance-related fees due to outperformance is unlikely to be materially adverse.

The Reporting and Disclosure Sub-Group is considering what other amounts could also be regarded not to be materially adverse for similar reasons.

8.9 Examples

To give some examples:

- If the Total Fees / total management costs for Year 0 were originally estimated to be 0.20% and the estimate for Year 0 was later updated to 0.30%, the increase in Total Fee or total management costs (as applicable) would be 0.10%. As a result, the change is likely to be material.

  (i) If the increase resulted solely from increases to performance fees / performance-related fees, due solely to higher actual outperformance, the change would not be materially adverse. This means that the trustee or responsible entity could rely on an online PDS update and must also issue a SEN, but would arguably have up to 12 months to issue the SEN (for example, it may be possible to provide the SEN with the next annual periodic statement and/or, for superannuation product members).

  (ii) If this increase was not related to performance fees / performance-related fees, the change would be materially adverse and a replacement PDS / supplementary PDS (where allowable – excludes shorter PDSs issued under Schedules 10D/10E) would be required. A SEN would also be required, arguably within 3 months.

- If the Total Fees / total management costs for Year 0 were estimated to be 0.20% and the estimate for Year 1 was 0.30%, then again the change is likely to be material.

  (i) If this increase arose solely from performance fees / performance-related fees due solely to higher estimated outperformance in Year 1 relative to Year 0, it would not be materially adverse. This means that the PDS would not be defective and so there would be no need for the trustee or responsible entity to physically update (replace or supplement) the PDS for this change (as this information relates to the subsequent Year 1 amounts). However, the trustee or responsible entity must issue a SEN, but would arguably have up to 12 months to issue the SEN (for example, it could potentially be provided with the next annual periodic statement).

(ii) If this increase was not related to performance fees / performance-related fees, this means that the PDS could be defective and the trustee or responsible entity should replace the PDS / issue a supplementary PDS (where allowable – excludes shorter PDSs issued under Schedules 10D/10E) for this change. The trustee or responsible entity must also issue a SEN, arguably within 3 months.

8.10 Annual reviews

Trustees and responsible entities must consider **around**[31] the end of each financial year whether disclosure for costs in the PDS needs to be updated to ensure the PDS is up-to-date (as required by section 1012J) and to avoid the PDS being likely to be misleading or deceptive.

Whether or not a trustee or responsible entity will need to update costs disclosed in a PDS will depend on whether there are changes to the amounts known or reasonably estimated of the costs incurred during the previous financial year, except for new products. In particular, trustees and responsible entities will need to consider around the end of each financial year – for example, around the end of Year 1:

- whether it holds new information about the indirect costs[32] for Year 0; and
- to what extent the fees and costs for Year 1 were different to Year 0.

If after the end of Year 1 a PDS becomes out of date because of costs which have changed for Year 1, the trustee or responsible entity may consider whether to rely on ASIC Corporations (Updated PDSs) Instrument 2016/1055 e.g. by posting the update on a website. A number of conditions must be met before the relief in the ASIC Instrument is available, including that the updated information includes no materially adverse information.

In this context, materially adverse information is defined in ASIC Corporations (Updated PDSs) Instrument 2016/1055 to mean "information of a kind the inclusion of which in, or the omission of which from, a Statement would render the Statement defective within the meaning of section 1021B [of the Corporations Act]."

In practice, if the difference in the updated indirect cost amount is materially adverse from the perspective of the reasonable person member, the trustee or responsible entity will not be able to rely on the Class Order relief to update the PDS after the end of Year 1 and will need to either reissue or supplement (depending on the type of PDS) the PDS.

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31 Practically, the trustee or responsible entity should turn its mind to this question before the end of the year to ensure that the PDS is kept up to date and not misleading. In commencing this consideration prior to year end the trustee or responsible entity may need to make reasonable estimates of costs for the remaining part of the year.

32 More generally and in addition to the consideration of indirect costs, to the extent that any part of management costs for a managed fund or fees for superannuation has been estimated it can be relevant to undertake this assessment for such other fees and costs. Although such a review is desirable, it not necessarily likely that the end of Year 1 is going to coincide with any information relevant to Year 0.

8.11 During a financial year

Trustees and responsible entities have an obligation to monitor changes to fees and costs during the financial year. Further, they must provide fees and costs information for the relevant reporting period where a member exits.

This does not mean that trustees and responsible entities need to obtain full fees and cost information more than once a year. However, those who collect information only once a year will need to determine a means by which they can be reasonably satisfied that there has been no changes during the year which would result in a material increase in the amounts disclosed in a PDS and that the information collected for the previous financial year provides a reasonable basis for estimating costs to include in exit statements for a future financial year.

Where new indirect costs information comes to the attention of the trustee or responsible entity during a financial year, the trustee or responsible entity should consider whether the new information means that the PDS is out of date or materially misleading or deceptive. The nature and materiality of the information is relevant to this consideration. A trustee or responsible entity is less likely to be required to reissue a PDS in the event of a non-material increase (or a material or non-material reduction). Any updating needed may be done in reliance on ASIC Corporations (Updated PDSs) Instrument 2016/1055 if the updated information is not materially adverse and the other conditions of that ASIC Instrument are met. On the other hand, a PDS is likely to be required to be reissued or, where permitted, supplemented if there is a material increase in the indirect cost calculation compared to the amount disclosed in the PDS.

An example of where these ongoing considerations arise for trustees and responsible entities is the situation whereby a trustee/responsible entity has included an estimated underlying investment fee in its PDS (e.g. based on costs for Year 0) and later (e.g. during Year 1) it receives actual figures periodically from its underlying providers of direct investments, which figures may be greater than the estimates stipulated. One of the reasons that this situation may occur is because of the different reporting periods applied by the trustee or responsible entity and the fund manager. For example, where a responsible entity's financial year is from 1 July to 30 June whereas a fund manager's is from 1 January to 31 December.

This situation creates the potential for frequent updating obligations for fees in PDSs and may occur despite the fact that the trustee or responsible entity complies with the fee and cost disclosure regime as at the date of the PDS and has taken into account the actual underlying fee for the previous year provided by the fund manager in order to estimate an amount for the PDS.

Concerns arise in this context since trustees and responsible entities are dependent on information provided to them by providers of direct investments and so generally cannot control when new fee and costs information is provided to them. Significant expense, inefficiency and member uncertainty could result if PDSs are required to be reissued frequently and at short notice in response to new information about estimated indirect costs.

Trustees and responsible entities should:

- include in PDSs clear warnings that the costs information included is based on information available and (if applicable) estimates as at the date of issue of the PDS and that the trustee's or responsible entity's website should be referred to by members for any updates which are not materially adverse from time to time;
- update members in accordance with ASIC Corporations (Updated PDSs) Instrument 2016/1055 where new costs information is not materially adverse. For these purposes, increases in performance-related fees solely attributable to higher investment outperformance are unlikely to be considered materially adverse;

- in ASIC's view, adopt a policy and procedure for gathering fees and costs information around the end of the financial year in order to calculate and form a view around PDS updates for fees and costs disclosure and have processes to identify when they come into receipt of updated costs information and therefore become aware of that information. This includes adopting a formal assessment so that they are able to fully assess the impact of new costs information within 30 days (the "review period") of the start of the annual review process, including the materiality of that information. If such information is not in a form or is not sufficiently complete or finalised in order to make that assessment, trustees and responsible entities should seek clarification before the end of the review period, noting that the extent to which such information needs to be clarified will depend on the materiality and its impact on disclosure. However if it becomes clear that an update is needed, it must be considered, without waiting on the end of the review period. Examples of where information may not be sufficiently complete or finalised include:

  (i) where accounts are provided but in unaudited form and are subject to change as a result of the audit process; and

  (ii) where the trustee or responsible entity is unable to reasonably ascertain the numerical impact of the information on the fees and costs disclosed in the PDS.

  Industry needs to work with ASIC on how this approach can be practically implemented in an efficient and cost effective manner for trustees, responsible entities and members.

8.12 Changes in performance-related fees

Performance-related fees are generally based on the previous financial year (in this example, Year 0). Accordingly, if during Year 1 the actual performance related fees are higher than Year 0 (other than those that must be disclosed prospectively e.g. new funds or fees payable to a trustee or responsible entity), that may not in itself trigger the requirement to reissue the PDS during year 1, although consideration will need to be given to whether the PDS remains up to date and whether it has become misleading or deceptive. Around the end of Year 1, the indirect costs in the PDS for year 2 will need to be calculated and will need to reflect the performance related fees in year 1.

If the performance-related fees in the PDS during Year 1 were based on a reasonable estimate of amounts for year 0 and new information is received during year 1 in relation to that estimate, it is also necessary to consider whether the estimate remains a reasonable estimate or not.

In considering the obligations on trustees and responsible entities to update PDSs in respect of changes in fees and indirect costs and the potential to rely on ASIC Corporations (Updated PDSs) Instrument 2016/1055 (assuming there has been an increase which is material and requires the PDS to be updated), an increase in the amount of a performance fee actually charged (including a performance-related fee incurred indirectly in an interposed vehicle) relative to an estimate in a PDS may not necessarily be materially adverse from the viewpoint of an member.

In certain situations, it may be possible for a trustee or responsible entity to form the view that a material increase in indirect and/or total costs which arises from a higher actual performance or performance-related fee incurred in a current financial year relative to an estimated performance or performance-related fee disclosed in the PDS is not materially adverse from the viewpoint of an member. For a trustee or responsible entity to be able to form this view (among other considerations), that increase must be solely attributable to higher investment outperformance and the basis for the performance fee calculation and entitlement must have been disclosed, including a provision for ranges if for multi-manager products. In taking this approach, assuming the conditions of ASIC Corporations (Updated PDSs) Instrument 2016/1055 are satisfied, any associated updating of the PDS may then occur by website disclosure.

Examples

If a performance fee is 10% of the investment performance above a certain benchmark (ie outperformance), then any amount actually charged which remains based on 10% of the outperformance is neither an increase nor a decrease to the performance fee, as illustrated below.

Performance fee		Outperformance		Fee amount
10%	x	5% (estimated)	=	0.5%
10%	x	4% (actual)	=	0.4%
10%	x	10% (actual)	=	1.0%

However, the following would be considered a performance fee <u>increase</u>, regardless of whether the actual performance fee amount charged was higher <u>or lower</u> than the estimate in the PDS.

Performance fee		Outperformance		Fee amount
10%	x	5% (estimated)	=	0.5%
20%*	x	2% (actual)	=	0.4%
20%*	x	2.5% (actual)	=	0.5%
20%*	x	5% (actual)	=	1.0%

* Any such increase to a (direct) performance fee would require 30-days' prior notice to members (ie which is an existing significant event notification requirement) and reissuing of the PDS.

8.13 Significant event notices

Trustees and responsible entities will need to consider their obligations to provide SENs to members about the fees and costs disclosure regime. Trustees and responsible entities[33] should consider their SEN obligations both at the time of complying with the fees and costs disclosure regime for the first time and on an ongoing basis.

SEE ASIC QUESTIONS AND ANSWERS 2

FEES AND COSTS DISCLOSURE

Is a SEN required?

Section 1017B of the Corporations Act requires a trustee or responsible entity to notify members of any material change to a matter, or significant event that affects a matter, being a matter that would have been required to be specified in a PDS prepared on the day before the change or event occurs. The discussion in sections 8.1 to 8.4 is relevant to this test.

If the only change to fees and costs disclosure as a result of compliance with the new fees and costs rules is a reclassification of amounts, then a SEN may not need to be provided. However, a SEN may be required if the changes involve an increase in the amounts disclosed.

Example 1: The fees and costs disclosure regime does not result in an increase in total amount of fees and costs disclosed

The fees and costs table for the pre-Class Order PDS discloses:

Type of fee	Amount	How and when paid
Investment fee	0.40% pa	
Indirect cost ratio	Nil	

The fees and costs table for the post-Class Order version of the PDS discloses:

[33] Responsible entities issuing ED securities do not have to issue SENs but have continuous disclosure obligations. This Guidance does not consider disclosure obligations under the continuous disclosure regime.

Type of fee	Amount	How and when paid
Investment fee	0.35% pa	
Indirect cost ratio	0.05% pa	

In this situation, a SEN is not required as there has been no material change to the PDS. The total amount of costs disclosed to members has not changed.

Example 2: The fees and costs disclosure regime does result in an increase in the total amount of fees and costs

The fees and costs table for the pre-Class Order PDS discloses:

Type of fee	Amount	How and when paid
Investment fee	0.40% pa	
Indirect cost ratio	Nil	

The fees and costs table for the post-Class Order version of the PDS discloses:

Type of fee	Amount	How and when paid
Investment fee	0.55% pa	
Indirect cost ratio	0.05% pa	

In this situation, a SEN is required as there has been a material change to the Produce Disclosure Statement. The total costs disclosed to members has increased by a material amount.

On an ongoing basis, trustees and responsible entities will also need to provide a significant event notice to update for material changes to the fees and costs information disclosed in the PDS. To ensure all existing members have access to the same information which is provided to new members, it is recommended that a significant event notice for changes to fees and cost amounts should be provided at the same time as the PDS is updated.

When must a SEN be given?

Refer to section 8.1 for information on materiality of changes.

A change that is an increase in fees or charges (other than an increase in a fee that results from an increase in costs) must be notified at least 30 days before the change (section 1017B(5), as amended). Other changes, including increases in fees due to an increase in costs, can generally be notified afterwards (and up to 12 months afterwards if the trustee or responsible entity reasonably believes that the change is not adverse to the member's interests and accordingly the member would not be expected to be concerned about the delay in receiving the information).

Accordingly, even where fee and cost amounts increase due to compliance with the new fees and costs regime, prior notice is not required. Whether a trustee or responsible entity will have 3 months or 12 months after the compliance date will involve a level of judgment. It is recommended that members be notified as soon as practicable after rolling over a PDS for compliance with the fees and costs disclosure regime and by no later than when the trustee or responsible entity provides annual statements in 2018.

On an ongoing basis, it is recommended that trustees and responsible entities notify members of material increases to fees and costs within 3 months of rolling over the PDS or issuing a Supplementary PDS for the increase.

Accordingly, trustees and responsible entities should consider timeframes for giving SENs with fees and costs information when rolling over their PDSs. It is recommended that trustees and responsible entities provide members with a SEN as soon as practicable after rolling over the PDS and by no later than when they provide the next annual statement.

What must be in a SEN?

A SEN must give the member the information that is reasonably necessary for the member to understand the nature and effect of the change.

Accordingly, a SEN for fees and costs changes should contain full details of the new fees and costs information for each investment option in the superannuation product or managed fund.

How can a SEN be provided or made available?

The IWG strongly encourages trustees and responsible entities to develop electronic means of providing SENs for changes to fees and costs information, such as through utilising the 'publish and notify' mechanism in ASIC Instrument 2015/647 and providing updated information on its public website.

9 DISCLOSURE IN PERIODIC STATEMENTS

Periodic statements must comply with the fees and costs disclosure regime, even if this covers a period when the relevant PDS was not yet required to comply with the fees and cost disclosure regime.

There remains a number of outstanding issues in relation to the disclosure of fees and costs in periodic statements. This section will be updated once those issues are resolved.

However, to assist industry, the following templates are provided by way of example to show possible disclosures in periodic statements for managed funds and superannuation products, excluding platforms.

SEE ASIC QUESTIONS AND ANSWERS 3 TO 5

FEES AND COSTS DISCLOSURE

Example 1: Sample disclosure for a periodic statement for a managed fund for reporting periods ending on or after 30 June 2018

FEES AND COSTS SUMMARY	**AMOUNT**
DIRECT FEES(1) These amounts have been deducted directly from your account and are reflected as transactions on this statement.	$
INDIRECT COSTS OF YOUR INVESTMENT(2) This approximate amount has been deducted from your investment and covers amounts that have reduced the return on your investment but are not charged to you directly as a fee.	$
TOTAL FEES AND COSTS YOU PAID[34] This approximate amount includes all the fees and costs which affected your investment during the period.	$
(1)Direct fees include: • [contribution fees (after any rebates)] • [member advice fees (after any rebates)] • [any rebates on indirect fees (see 'Indirect costs of your investment' below) that have been paid to you by allocating additional units in your account, which may result in a negative total direct fees amount]. (2)Indirect costs of your investment include: • [management fees] • [performance fees] • [expense recoveries] • [performance-related fees in underlying funds] • [any rebates on indirect fees that have been paid separately into your bank account] • [any other indirect costs].	
ADDITIONAL EXPLANATION OF FEES AND COSTS	
The following approximate amounts are additional to the 'Total fees and costs you paid'[36] amount shown above.	
FEE OR COST	**AMOUNT**
BUY/SELL SPREAD This [approximate] amount represents the total dollar impact of the buy/sell spreads applicable on [the Fund/your chosen Fund(s)/investment option(s)] for all of your transactions shown on this statement.	$
<TRANSACTIONAL AND OPERATIONAL COSTS> ***or*** **<TRANSACTION COSTS>**	$

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34 Before determining whether to adopt this heading, responsible entities should note that the law requires this heading to be 'Total fees you paid', and does not permit any departures from the prescribed wording. Inclusion of the words 'and costs' does represent a technical departure from the wording prescribed in the law. However, this alternative heading may be more intuitive for the member since the total represents the sum of the fees and costs amounts shown above and more closely aligns with the prescribed description for that section, which includes 'and costs'.

This approximate amount represents your proportionate share of any net <transactional and operational costs> *or* <transaction costs> (after any transaction costs that have been recovered from you via buy/sell spreads – refer above) and operational costs (including any property operating costs [*and any operational borrowing costs*]) borne by all investors in [the Fund/your chosen Fund(s)/investment option(s)].	
<BORROWING COSTS> This approximate amount represents your proportionate share of any applicable borrowing costs incurred indirectly in relation to the investment strategy of [the Fund/your chosen Fund(s)/investment option(s)].	$

Notes for Example 1:

- The description and presentation of Direct Fees is not prescribed by law. Therefore, rather than using footnotes identifying the types of direct fees included in this total, responsible entities could choose to provide itemised sub-totals for each category of direct fees, either here (with or without an overall total) or under Additional Explanation of Fees and Costs.
- Rather than using footnotes identifying the types of indirect costs included in this total, responsible entities could choose to provide itemised sub-totals for each category of indirect costs, either in the section Indirect Costs of Your Investment or under Additional Explanation of Fees and Costs. However, in any event, the total amount must be included in the section Indirect Costs of Your Investment and the responsible entity should consider whether the disclosure approach is clear, concise and effective.
- ASIC has stated that there is no specific requirement for buy/sell spreads incorporated in a unit price to be disclosed in periodic statements for managed funds. However, ASIC considers members need to be told that a buy/sell spread is being applied to member transactions and encourages separate dollar disclosure. If separate dollar disclosure of buy/sell spreads based on the member's transactions during the reporting period is not provided, then dollar transaction costs must be calculated and reported gross of any amounts recovered via buy/sell spreads.
- Borrowing costs may only need to be disclosed separately if they are not disclosed as part of transactional and operational costs. Generally, a managed fund would disclose operational borrowing costs as part of transactional and operational costs, whereas strategic borrowing costs (for which there is currently no specific or general legal requirement to disclose) could be disclosed separately (refer to section 4.8 for examples of strategic and operational borrowing costs).
- It is optional whether to include the descriptions of Direct Fees and Indirect Costs of Your Investment in notes (1) and (2). If a responsible entity chooses to include notes, the IWG recommends that it customise them to reflect what is actually included in the relevant amounts.
- Example 1 assumes that details of any incidental fees and services fees have been included in another part of the periodic statement. It also assumes that the managed fund is a 'pass-through' tax entity and so there is no benefit of tax deductions to pass onto members.

Example 2: Sample disclosure for a periodic statement for a managed fund for reporting periods ending before 30 June 2018 (minimum transitional reporting requirements)

FEES AND COSTS SUMMARY	**AMOUNT**
DIRECT FEES These amounts have been deducted directly from your account and are reflected as transactions on this statement.	$
INDIRECT COSTS OF YOUR INVESTMENT This approximate amount has been deducted from your investment and covers amounts that have reduced the return on your investment but are not charged to you directly as a fee.	$
TOTAL FEES YOU PAID This approximate amount includes all the fees and costs which affected your investment during the period.	$

Notes for Example 2:

- If a pre-1 July 2017 periodic statement for a managed fund complied prior to the fees and costs disclosure changes, the only change required to a periodic statement issued for reporting periods before 30 June 2018 is expansion of the amounts disclosed to include indirect costs and other amounts included in management costs under the fees and costs disclosure regime. New fields providing dollar disclosure of other amounts are not required until reporting periods ending on or after 30 June 2018.
- As there is no change to the Additional Explanation of Fees and Costs during the transitional period before 30 June 2018, Example 2 does not include an Additional Explanation of Fees and Costs section.

Example 3: Sample disclosure for a periodic statement for a superannuation product for reporting periods ending on or after 30 June 2018

FEES AND COSTS SUMMARY

	GROSS AMOUNT[1]	TAX BENEFIT[2]	NET AMOUNT[3]
DIRECT FEES[4] These amounts have been deducted directly from your account and are reflected as transactions on this statement.	$	$	$
OTHER FEES OF YOUR INVESTMENT[5] This approximate amount or amounts have been deducted from your investment and covers fees that are not reflected as transactions on this statement.	$	$	$
INDIRECT COSTS OF YOUR INVESTMENT[6] This approximate amount has been deducted from your investment and covers amounts that have reduced the return on your investment but are not charged as a fee.	$	$	$
TOTAL FEES AND COSTS YOU PAID[35] This approximate amount includes all the fees and costs which affected your investment during the period. <The Total fees and costs you paid does not include the property operating costs that you incurred during the period. An estimate of the amount of property operating costs attributed to your investment during the reporting period is provided in the Additional Explanation of Fees and Costs.>[36]	$	$	$

1. Gross amounts are inclusive of the net effect of GST.
2. Tax benefit amounts represent the estimated tax benefit available to [the Fund /each MySuper product/each investment option] on relevant fees and costs, where applicable, which have been passed on to members in the form of a reduced fee or cost.
3. Net amounts are the estimated effective fees and costs you paid after any tax benefits passed on to members.
4. Direct fees include:
   - [contribution fees]
   - [dollar-based administration fees]
   - [member advice fees]
   - [insurance premiums]

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35 Before determining whether to adopt this heading, trustees should note that the law requires this heading to be 'Total fees you paid', and does not permit any departures from the prescribed wording. Inclusion of the words 'and costs' does represent a technical departure from the wording prescribed in the law. However, this alternative heading may be more intuitive for the member since the total represents the sum of the fees and costs amounts shown above and more closely aligns with the prescribed description for that section, which includes 'and costs'.

36 This is sample text that can be included for reporting periods ending on or before 29 September 2018 if dollar amounts of property operating costs are not included in the periodic statement. For reporting periods ending on or after 30 September 2018, property operating costs must be included in Other Fees of Your Investment (if they are included as part of the investment fee in the PDS) or Indirect Costs of Your Investment (if an election has been made, and they are included as part of the indirect cost ratio in the PDS).

- [any rebates on indirect fees (see 'Other fees of your investment') that have been paid to you by allocating additional units in your account, which may result in a negative total direct fees amount].

5. Other fees of your investment include:
   - [investment fees, including performance fees/performance-related fees]
   - [percentage-based administration fees]
   - [buy/sell spreads charged on your transactions].

6. Indirect costs of your investment include:
   - [expense recoveries]
   - [performance-related fees in underlying funds]
   - [net transaction costs]
   - [operational costs, including any operational borrowing costs and any property operating costs]
   - [any other indirect costs].

ADDITIONAL EXPLANATION OF FEES AND COSTS	GROSS AMOUNT[1]	TAX BENEFIT[2]	NET AMOUNT[3]
<BORROWING COSTS> This approximate amount represents your proportionate share of any applicable borrowing costs incurred indirectly in relation to the investment strategy of [the Fund/your chosen investment option(s)] and is additional to the 'Total fees and costs you paid'[37] amount above. *OR*	$	$	$
<TOTAL FEES AND COSTS YOU PAID PLUS BORROWING COSTS> This approximate amount includes your proportionate share of any applicable borrowing costs incurred indirectly in relation to the investment strategy of [the Fund/your chosen investment option(s)].	$	$	$

Notes for Example 3:

- Regulation 7.9.60B(3) of the Corporations Regulations requires transactions, including fees deducted from member accounts, to be disclosed net of any tax benefit passed on to members. However, the IWG notes that in Regulatory Guide 97, ASIC expects that two transactions are shown – one reflecting the full amount of the transaction and another for any tax benefit which is passed on. Further, in accordance with changes made by ASIC Instrument 2017/664, Other Fees of Your Investment and Indirect Costs of Your Investment must be disclosed on a gross (ie including the amount of the tax benefit) basis. The three-column approach is not a legal requirement but is suggested as a possible means of providing clearer disclosure to members on the basis that it allows for Total fees and costs you paid totals to be provided for each of the Gross Amount, Tax Benefit and Net Amount columns rather than having a single total which represents a mix of Gross Amounts and Net Amounts.
- If all Indirect Costs of Your Investment are incurred in interposed vehicles and / or no tax benefit is passed on to members, both the Gross Amount and Net Amount would be the same, with the Tax Benefit shown as a zero amount. If there is a mix of indirect costs incurred at the superannuation fund level (where there is a tax benefit on those amounts which is passed on to members) and others incurred in interposed vehicles, then the components would need to be calculated separately before amalgamating into an overall total reflecting the composite tax benefit position to the member of those indirect costs. In this case, the Tax Benefit amount would be neither 0% nor 15% of the Gross Amount, but rather a figure expressed in dollar terms that represents the relevant mix.
- The description and presentation of Direct Fees is not prescribed by law. Therefore, rather than using footnotes identifying the types of direct fees included in this total, trustees could choose to provide itemised sub-totals for each category of Direct Fees, either here (with or without an overall total) or under Additional Explanation of Fees and Costs.
- Rather than using footnotes identifying the types of indirect fees and costs included in the totals, trustees could choose to provide itemised sub-totals for each category of indirect fees and costs, either in the section Other Fees of Your Investment or Indirect Costs of Your Investment, or under

Additional Explanation of Fees and Costs. However, in any event, the relevant total amount must be included in the sections Other Fees of Your Investment and Indirect Costs of Your Investment and trustees should consider whether the disclosure approach is clear, concise and effective.

- If a trustee chooses to include footnotes, the IWG recommends that it customise them to reflect what is actually included in the total amounts.
- Generally, any operational borrowing costs forming part of transactional and operational costs would be disclosed as part of the total Indirect Costs of Your Investment, whereas strategic borrowing costs would be disclosed separately or as an amount combined with Total Fees and Costs You Paid (refer to section 4.8 for examples of strategic and operational borrowing costs), in accordance with the PDS disclosure.

Example 4: Sample disclosure for a periodic statement for a superannuation product for reporting periods ending before 30 June 2018 (minimum transitional reporting requirements)

FEES AND COSTS SUMMARY

	GROSS AMOUNT[1]	TAX BENEFIT[2]	NET AMOUNT[3]
DIRECT FEES[4] These amounts have been deducted directly from your account and are reflected as transactions on this statement.	$	$	$
OTHER FEES OF YOUR INVESTMENT[5] This approximate amount or amounts have been deducted from your investment and covers fees that are not reflected as transactions on this statement.	$	$	$
INDIRECT COSTS OF YOUR INVESTMENT[6] This approximate amount has been deducted from your investment and covers amounts that have reduced the return on your investment but are not charged as a fee.	$	$	$
TOTAL FEES AND COSTS YOU PAID[37] This approximate amount includes all the fees and costs which affected your investment during the period. The Total fees and costs you paid does not include the buy-sell spread fee, because it is not reasonably practicable for us to include the buy-sell spread fee you incurred during the period.[37] The Total fees and costs you paid does not include the property operating costs that you incurred during the period.[38]	$	$	$

1. Gross amounts are inclusive of the net effect of GST.
2. Tax benefit amounts represent the estimated tax benefit available to [the Fund/each MySuper product/each investment option] on relevant fees and costs, where applicable, which have been passed on to members in the form of a reduced fee or cost.
3. Net amounts are the estimated effective fees and costs you paid after any tax benefits passed on to members.
4. Direct fees include:
   - [contribution fees]
   - [dollar-based administration fees]
   - [member advice fees]
   - [insurance premiums]

37 This is transitional text to be included if the dollar amount of buy/sell spreads incurred by the member throughout the reporting period is not included as part of the amount of Other Fees of Your Investment. This statement can be provided in a separate document that accompanies the periodic statement if it is not reasonably practicable to include in this position on the periodic statement.

38 This is transitional text to be included if the dollar amount of property operating costs notionally allocated to the member for the reporting period is not included within the amount of Indirect Costs of Your Investment. This statement can be provided (consecutively to the above buy-sell spread statement) in a separate document that accompanies the periodic statement if it is not reasonably practicable to include in this statement in the periodic statement.

- [any rebates on indirect fees (see 'Other fees of your investment') that have been paid to you by allocating additional units in your account, which may result in a negative total direct fees amount].

5. Other fees of your investment include:
   - [investment fees, including performance fees/performance-related fees]
   - [percentage-based administration fees]

6. Indirect costs of your investment include:
   - [expense recoveries]
   - [performance-related fees in underlying funds]
   - [net transaction costs]
   - [operational costs, including any operational borrowing costs]
   - [any other indirect costs].

ADDITIONAL EXPLANATION OF FEES AND COSTS

BORROWING COSTS

You can obtain information about borrowing costs for [the Fund/each MySuper product/each investment option] from <www.URL details> or by contacting us.

10 PLATFORMS

10.1 What is a platform?

A platform product is a custodial arrangement:

GOOD PRACTICE

- which allows a security or interest in an underlying fund or financial product ("**underlying accessible product**") to be acquired on the instruction, direction, or request of a member; and
- where the relevant investments that the member may choose are in a list published by the trustee, responsible entity or IDPS operator, collectively "**platform operator**".

Generally, underlying accessible products include listed shares, exchange traded funds (ETFs), listed real estate investment trusts (REITs) and registered managed funds. However, they can also include unlisted securities, unregistered managed funds and other entities.

The rules relating to the disclosure of fees and costs vary between the different types of platform arrangement being:

- the trustees of a superannuation platform product or "**super wrap**";
- the operator of an Investor Directed Portfolio Service ("**IDPS**"); and
- the responsible entity of an IDPS-like managed fund.

10.2 Statement of principle

In the interest of fee and cost comparability, the IWG believes as a matter of principle that the amounts disclosed in relation to the fees and costs of underlying accessible products by platform operators should be the same amounts that are required to be disclosed by an equivalent non-platform operator – that is:

- super wrap disclosure should be on the same basis as superannuation product disclosure; and
- IDPS and IDPS-like managed fund disclosure should be on the same basis as managed fund disclosure.

However, the IWG notes that the format of this disclosure will not be identical to an equivalent non-platform product as the fees and costs of underlying accessible products for platforms do not need to be disclosed under Schedule 10.

10.3 Summary

The following table summarises the Guidance for platform operators:

Amount in underlying accessible product	Main fees and costs table in PDS or IDPS Guide	Statutory fee example in PDS or IDPS Guide	Additional examples in PDS or IDPS Guide	Investment menu	Periodic statements (super wraps and IDPS-like only)
Management costs	Exclude	Exclude	Include	Include	Include
Buy/sell spreads	Exclude	Include for super wraps only (in a footnote)	Include for super wraps only (in a footnote)	Include	Include for super wraps only
Transactional and operational costs	Exclude	Exclude	Include explicit costs for super wraps only	Include	Include explicit costs for super wraps only

The IWG notes that some platform operators currently include information on the fees and costs of underlying accessible products in the main fee table in the PDS or IDPS Guide and statutory fee example and that they may adopt an alternate position to the Guidance set out in this section. The IWG reiterates that alternative practices may be equally compliant with the fees and costs disclosure regime and platform operators must form their own views on how to comply with the fees and costs disclosure regime in a manner which achieves the best outcomes for their members.

10.4 Main fees and costs table

Super wraps must include the prescribed fee table for superannuation products. IDPS Guides and PDSs for IDPS-like managed funds must include the prescribed fee template for managed funds, as set out in Schedule 10 (where they adopt a long-form PDS).

Under the platform test (refer to section 3.5) underlying accessible products offered on platforms are not interposed vehicles and accordingly platform operators should not include any amount relating to fees and costs of an underlying accessible product acquired through the platform in the main fee table.

To avoid misleading members, the IWG recommends that an IDPS Guide or PDS include statements immediately after the main heading 'Fees and other costs' or 'Fees and costs' (depending on the form of the PDS or IDPS Guide) to the effect that:

- The total fees and costs payable by a member will include the costs of the platform as well as the costs of any underlying accessible products chosen by the member.
- It is important that the member understands the fees and costs of any underlying accessible products chosen by them and that those fees and costs will be in addition to the fees and costs for the platform, together with transaction and account costs incurred on behalf of the client or member.
- The costs of the underlying accessible products chosen by the member will be generally be set out in a disclosure document or PDS for the underlying accessible product.

The above statements are required for IDPS and IDPS-like managed funds under existing ASIC Class Orders[39]. The IWG recommends that the above statements are also included in a super wrap PDS.

Further, where applicable, platform operators should reference in the appropriate section of the main fee table that underlying fees and costs may apply.

For super wraps:

- for underlying management costs, reference should be made in the main fee table in either the investment fee or the indirect cost ratio rows; and
- for underlying buy/sell spreads, reference should be made in the main fee table in the buy/sell spread row.

In making the reference to underlying management costs under the indirect cost ratio, the trustee of a super wrap is not required to make any election to treat any of these costs as indirect costs rather than as investment fees, as they are not required to be included in the fee table.

For IDPSs and IDPS-like managed funds, reference to management costs of underlying accessible products should be made in the management costs row of the main fees and costs table.

Trustees of super wraps should continue to provide details (including amounts) of transaction fees charged directly to the member's cash account (eg brokerage fees) under 'Other fees and costs' in the fees and costs table. Other platform operators should disclose such amounts in the Additional Explanation of Fees and Costs.

[39] Class Order 13/762 in relation to an IDPS-like managed fund and Class Order 13/763 in relation to an IDPS.

10.5 Additional Explanation of Fees and Costs

Certain additional information must be included under the heading of Additional Explanation of Fees and Costs (Additional Explanation of Fees and Costs) including details of performance fees, advice fees and transactional and operational costs.

Where the platform operator directly deducts these costs, they must be included in the Additional Explanation of Fees and Costs, for example brokerage fees on listed security transactions and member advice fees.

As a matter of good practice the IWG recommends that information about the types of fees and costs of underlying accessible products should be included in the Additional Explanation of Fees and Costs including a general description of the nature of management costs, transactional and operational costs and buy/sell spreads of any managed funds. It is not necessary to quantify amounts, however, a reference should be made to investment menu disclosure (or equivalent) and the PDS for the underlying accessible product for further information.

10.6 Statutory example of annual fees and costs

An IDPS Guide or PDS must contain an example of annual fees and costs as prescribed in Schedule 10.

Platform operators should not include any amounts relating to the fees and costs of underlying accessible products acquired through the platform in this example.

However, to avoid misleading members, an IDPS Guide or PDS should include prominent statements following the example that the fees and costs of the platform relate to access to the investments on the list, not the costs within those investments, and that additional costs will be charged by the underlying accessible products that the member decides to invest in.

Where the law requires the name of a balanced investment option or other investment option to be set in the example, the IWG recommends that the name of the platform be included but not the name of or reference to any investment option. In addition, platform operators should make it clear immediately after the example that the fees and costs should only be compared with another platform.

10.7 Additional examples of annual fees and costs

The IWG recommends that an IDPS Guide or PDS include additional examples showing the total fees and costs of both the platform, and the accessible financial products that may be acquired through the platform.

When disclosing the fees and costs of accessible securities or investments, super wraps should calculate these amounts on the same basis as the indirect cost ratio i.e. those costs incurred in the previous financial year divided by the total average net assets, unless the security or financial product is new, in which case costs must be estimated based on the current financial year.

At least one additional example provided should use the same assumptions and be on the same basis, as the statutory example of annual fees and costs required by Schedule 10 i.e. based on a balance of $50,000 (or minimum balance if higher) throughout the period and, for a managed fund, a contribution of $5,000 during the year. As such, buy/sell spreads should not be included in the main example but should be included in the footnotes in line with the statutory example.

If applicable, further examples should be provided to cover other underlying accessible products that may be acquired through the platform, such as term deposits and listed securities, and:

- should express the total fees and costs as a proportion of the total price paid in acquiring the accessible securities and accessible financial products; and

- should be examples that the platform operator has reasonable grounds for believing are based on estimates of the fees, charges and expenses that are within the range typically charged for accessible securities and accessible financial products of the relevant kind.

The above examples are required for IDPS and IDPS-like managed funds under existing ASIC Class Orders[40]. The IWG recommends that the above statements are also included in a super wrap PDS.

Further, in the case of a super wrap, the additional examples should include the fees and costs of the underlying accessible products on the same basis as a non-platform superannuation product, including the relevant footnotes relating to buy/sell spreads, even if the financial product is a managed fund.

For an investment in a managed fund, trustees of super wraps could base any reasonable estimate on the disclosed management costs plus the disclosed T&O costs in the PDS, however this may over-state costs due to the inclusion of 'implicit' T&O costs (such as bid/offer spreads on physical securities including market impact) which are not required to be shown in the fee table for a superannuation product. If trustees of super wraps do rely on the underlying managed fund PDS disclosure when providing information for annual examples, then statements to this effect could be made in a footnote.

In the case of a shorter PDS additional examples could be incorporated by reference.

In the interests of member clarity and understanding, the terminology used to describe the fees and costs of underlying accessible products in the additional examples should align with the terminology used to describe these costs in periodic statements (refer to section 10.9).

Whilst in Regulatory Guide 97, ASIC encourage platform operators to provide for each investment on their list, an example of total fees and costs, including the costs of the platform and the costs of the accessible financial product, the IWG believes that this disclosure would be overly onerous on platform operators and notes it is not a requirement for a non-platform product to show the equivalent 'cost of product' for all investment options.

10.8 Additional information

Platform operators generally provide an investment menu (or equivalent) that lists the underlying accessible products available through the platform for the convenience of members. Generally, this document should include amounts for the following fees and costs, if applicable, as they are disclosed in the relevant underlying PDS:

- management costs
- transactional and operational costs (net of any buy/sell spread recovery)
- buy/sell spreads.

However, for super wraps, transactional and operational costs as disclosed in the underlying managed fund PDS may include 'implicit' transactional and operational costs (such as bid/offer spreads on physical securities including market impact) which are not required to be shown in the additional examples of annual fees and costs. Managed fund providers and data aggregators such as Morningstar are working towards providing platforms with the fees and costs of each investment on a superannuation-equivalent basis to facilitate more comparable disclosure with non-platform superannuation products.

Accordingly, trustees of super wraps may wish to show only explicit transaction costs in the investment menu (or equivalent) if these are available or if the trustee can reasonably estimate these amounts, in which case it could be noted that these amounts may not align to the underlying managed fund PDS.

[40] Class Order 13/762 in relation to an IDPS-like managed fund and Class Order 13/763 in relation to an IDPS.

Transitional guidelines

Platform operators are unlikely to have access to all the required fee and costs information of underlying accessible products until the underlying fund manager has updated its relevant disclosure materials.

Platform operators should update investment menus (or equivalent) as soon as practical after 30 September 2017.

10.9 Periodic statement disclosure

Only trustees of super wraps are required by section 1017D of the Corporations Act to issue periodic statements. While IDPS operators are not required to issue periodic statements, the IWG considers that it would be good practice for IDPS operators to disclose fee and costs in accordance with Schedule 10 and this Guidance as if it were a managed fund when providing an annual member statement to members.

SEE ASIC QUESTIONS AND ANSWER 6

FEES AND COSTS DISCLOSURE

For a periodic statement not to be misleading or deceptive, the IWG recommends that platform operators include two additional sections in their periodic statements.

Firstly, platform operators should include an estimate in dollars of the fees and costs of underlying accessible products on the same basis as an equivalent non-platform product. The following text and the appropriate amount in dollars, should be inserted immediately after the part of the periodic statement which sets out the 'Total fees you paid':

> *Other costs*
> *This approximate amount has been deducted from the investments you have chosen and covers amounts that have reduced the return on these investments but are not charged to you directly as a fee.*

The amount shown should be a single total amount in dollars of the fees and costs of underlying accessible products calculated on the same basis as an equivalent non-platform product, and include the impact of buy/sell spreads on member transactions (even if the platform is a super wrap and the underlying accessible product is a managed fund). ASIC states that this amount would need to include an estimate of all costs as if the entities excluded under the platform test were interposed vehicles calculated and be based on the actual holdings of the member in the relevant period.

Secondly, the following text and appropriate amount, in dollars, should be inserted immediately after the part of the periodic statement which sets out the 'Other costs':

> *Total fees and costs you paid*[41]
> *This approximate amount includes all the fees and costs which affected your investment during the period.*

The amount set out in the 'Total fees and costs you paid' section should be sum of the 'Total fees you paid' and 'Other costs'.

For both 'Other costs' and 'Total fees and costs you paid', the text outlined above should appear immediately underneath the headings and should not, for example, be included in a footnote or endnote.

41 In ASIC Frequently Asked Question 6, ASIC refers to this section as "Total costs".

Further, platform operators should consider whether the inclusion of the sections:

- in relation to super wraps, 'Other fees of your investment'; and
- in relation to all platform products, 'Indirect costs of your investment',

in periodic statements for platform products is likely to confuse members as these amounts would always be displayed as 'nil' due to the design of the product and the sections do not correlate to sections in the PDS or IDPS Guide. Platform operators should consider omitting these sections altogether[42].

Further, the prescribed text for the section 'Total fees you paid' includes a statement that the amount includes all the fees and costs which affected the member's investment during the period. The words 'and costs' could be misleading or deceptive, if the only cost amounts to be included are 'Other costs' that follow this disclosure. Platform operators should consider omitting the words 'and costs' from this section[43].

The IWG is still considering the disclosure of borrowing costs and transactional and operational costs of underlying accessible products in periodic statements issued by trustees of super wraps.

Transitional guidelines

Generally, platform operators currently include either the relevant indirect cost ratio percentage rate, or a dollar estimate of the management costs of managed funds in 'Indirect costs of your investment' in periodic statements based on the last financial year indirect cost ratio percentage rate provided by data aggregators such as Morningstar.

Implementation of this Guidance is therefore dependent on platform operators having access to the required indirect cost ratio percentage rates for the underlying accessible products (including, for trustees of super wraps, the equivalent super basis indirect cost ratio percentage rate) from data providers, which in turn is dependent on providers of direct investments supplying this data.

Further, for those platform operators that currently do not disclose dollar amounts based on individual member holdings, system functionality will need to be built to comply with dollar costs disclosure.

The IWG recommends that all platform operators adopt dollar cost disclosure as set out in this Guidance for a periodic statement that is required to be given on or after 1 January 2019.

Where full or partial dollar cost disclosure is not currently practicable, the IWG recommends that periodic statements:

- state the extent to which the costs in any underlying products to which the platform test applies are not included in 'Total fees you paid'; and
- include an example of annual fees and costs as indicated in section 10.6 that includes the fees and costs of a typical accessible managed fund (or listed security if no managed funds are offered).

As a transitional measure prior to full dollar cost disclosure, the IWG encourages platform operators to provide a link to the investment menu (or equivalent) which sets out the fees and costs of the underlying accessible products.

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42 In forming a view on whether to omit these sections, platform operators should take into account that the law does not permit their omission, and their omission would be a technical departure from the law.

43 In forming a view on whether to omit these words, platform operators should take into account that the law does not permit their omission, and their omission would be a technical departure from the law.

Appendix A – Additional Background Information

Common Investment Structures

There are a variety of different ways in which trustees and responsible entities invest the assets of a fund.

Profit-for-member superannuation funds

Common structures in profit-for-member superannuation funds include through mandates awarded to investment managers, unlisted pooled vehicles and direct investments (using in-house expertise).

Trustees of profit-for-member superannuation funds do not normally charge trustee fees or performance fees. Rather, the costs of investing (including investment management fees and, the costs of running an investment team and trustee office eg salaries) are regularly paid from the fund.

In practice, many profit-for-member funds manage costs through the use of one or more expense reserves whereby relevant costs are paid for from the reserve, and the reserve is funded through the deduction of fees from member accounts. For example, administration fees may be deducted from member accounts and paid into an administration expense reserve and all administration costs of the superannuation fund are paid from that reserve. While the administration fee would be set on a cost recovery basis, it would be rare that the total administration fees paid in a year to the reserve exactly matched the administration costs paid by the fund that year.

Many trustees of profit-for-member superannuation funds will appoint investment managers. A majority of the investment managers appointed are unrelated to the trustee, but some trustees will appoint a related party investment manager.

Fee structures in mandates involve the payment of a fee to the investment manager which, in some cases, include a performance fee. Where the investment manager manages MySuper assets, the performance fee must satisfy section 29VD of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act). It is possible that the portfolio of assets managed by the investment manager includes interposed vehicles, and fees are charged by the interposed vehicles and costs are incurred by the interposed vehicles for which fees and costs would also need to be considered.

Unlisted pooled vehicles generally consist of limited partnerships, mutual funds and companies when offered by foreign providers of direct investments, and trusts when offered by Australian providers of direct investments. Fees may be charged by the general partner in a limited partnership, the mutual fund, the company or the trustee of the trust. Performance fees (or 'carried interest' or 'carry' in the case of private equity and hedge funds structured as limited partnerships) may also be payable. The limited partnership, mutual fund, company or trust may invest in an interposed vehicle which may also incur fees and costs.

The trustee of a profit-for-member fund may also make a direct investment. Depending on the structure adopted by the trustee to make direct investments, there could be feeder funds which have investment-related and administration-related costs.

Retail superannuation funds

Retail superannuation funds tend to invest through a related party pooled structure, which is normally either a life insurance policy or one or more unit trusts.

Historically, trustees of retail superannuation funds often invested through an investment-linked life insurance policy issued by a related party life insurer. There may be subsequent layers of feeder funds (normally in the form of unit trusts / managed funds whose trustee / responsible entity is a related party) between the life insurer and the end investment.

More recently, trustees of retail superannuation funds will often invest in one or more “head” unit trusts. There may be subsequent layers of feeder funds (normally in the form of related party unit trusts / managed funds) between the head trust(s) and the end investment.

Some trustees of retail superannuation funds will enter into an investment management agreement, although this would normally be with a related party.

Fee structures for retail superannuation funds vary significantly and can include:

- the trustee of the superannuation fund charging a fee (and possibly a performance fee) and paying all fund expenses from the fee revenue (i.e. an ‘all inclusive’ fee type)
- the trustee of the superannuation fund charging a fee (and possibly a performance fee) but also recovering some or all of the fund expenses from the fund
- the life insurer charging a fee (and possibly a performance fee) through the policy and being responsible for all fund expenses. In these circumstances, the trustee would not normally itself charge a fee
- the trustee / responsible entity of the “head” trust charging a fee (and possibly a performance fee) and being responsible for all fund expenses. In these circumstances, the trustee would not normally itself charge a fee.

There are also instances where a trustee or life insurer pays all day-to-day fund expenses from the fees it charges but will recover large ad hoc fund expenses from members.

Managed funds

The investment structures for managed funds vary depending on asset class and even within asset classes can vary widely.

Responsible entities will often charge management fees and, at times, performance fees. They may also appoint investment managers who charge fees and / or invest in interposed vehicles which incur fees and costs.

Appendix B Global references

There is work being undertaken internationally, which generally focuses on investment managers developing guidance, including:

- OICU-IOSCO Good Practice for Fees and Expenses of Collective Investment Schemes August 2016
- The Financial Conduct Authority in the UK https://www.fca.org.uk/

  Note: June 2016 final report on asset management costs: https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf

  Note: October 2016 discussion paper issued regarding transaction cost disclosure: https://www.fca.org.uk/news/press-releases/fca-publishes-proposals-transactions-cost-disclosure

  Note: November 2016 Asset Management Market Study Interim Report: https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf

- Global Investment Performance Standards http://www.cfapubs.org/toc/ccb/2010/2010/5
- The Transparency Taskforce http://www.evidenceinvestor.co.uk/introducing-the-transparency-task-force/
- Transparency International https://www.transparency.org/
- Federation of the Dutch Pension Funds http://www.pensioenfederatie.nl/Document/Publicaties/Servicedocumenten/Uitvoeringskosten_no2_English.pdf
- LCP investment manager fee survey https://www.lcp.uk.com/media/1071517/lcp-investment-management-fees-survey-2015.pdf

AIST has also undertaken research which examines international investment disclosure trends: http://www.aist.asn.au/media/958355/international_investment_disclosure_trends_-_final_draft.pdf