THE Frontier Line

Thought leadership and insights from Frontier Advisors

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Fees and Costs Disclosures

The implications of ASIC's revised Regulatory Guide 97 for Superannuation Funds

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The revised Regulatory Guide 97

In November 2015, the Australian Securities & Investments Commission (ASIC) rereleased its *Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (RG 97, or Guide). This amended and updated RG 97 provided an additional 45 pages of policy to guide product issuers (i.e. superannuation funds) on how to disclose fees and costs, and superseded the previous version that was issued by ASIC in November 2011.

The purpose of the changes is to provide clarity and promote greater accuracy and consistency in disclosing fees and costs. Indeed, in public statements since the release of the revised RG 97, ASIC has gone further, recently commenting at an industry conference that "…ASIC says it is motivated by the fact that inconsistent and under reporting of superannuation fees is harming investors and as a regulator it will not allow this to continue."[2]

The new rules were to be mandatory for Product Disclosure Statements (PDSs) issued on or after 1 February 2017, and for Periodic Statements issued on or after 1 January 2018.

However, in response to applications from industry associations, ASIC recently announced an extension to the original transition period for product issuers to comply with the updated fees and costs disclosure requirements[1].

- Product issuers can now elect to extend the transition period to 30 September 2017 by notifying ASIC in writing by 31 January 2017.
- Product issuers who decide to take advantage of this extension must still provide information on fees and costs, as required by the updated RG 97 disclosure requirements, to ASIC by 1 March 2017.
- Product issuers which do not have to take advantage of this extension will be required to meet the updated RG97 disclosure requirements by 1 February 2017.
- Product issuers may also opt in early at any stage.

The previous RG 97 required product issuers to disclose a range of costs such as management fees and, where applicable, performance fees, establishment fees, contribution fees, withdrawal fees and termination fees. With the revised RG 97, ASIC has extended this disclosure to capture all fees and costs that detract from the value of the investment, including through any holding vehicle, by looking all the way through to the ultimate reference asset (whether or not physically held).

Included in the list of fees and costs that now must be disclosed, in addition to those noted, are the following.

- Operational costs (including custody and administration costs, legal fees, directors fees and regulatory and compliance costs not included in management fees).
- Transaction costs (including brokerage costs, buy/sell spreads, stamp duty and other fees that are not included in management fees or operational costs).
- Foreign exchange costs.
- Over-the-counter (OTC) derivatives costs.
- Leverage/borrowing costs (note though that ASIC is still seeking submissions on the disclosure of borrowing costs and, as such, the RG 97 requirements may change).
- Securities lending costs.

1. Australian Securities & Investments Commission, *16-412MR ASIC extends the transition period for superannuation trustee and responsible entities to comply with updated fee and cost disclosure requirements*, 29 November 2016.
2. Greg Tanzer, ASIC Commissioner, quoted in "Under reporting of super fees harming investors: ASIC", Darren Snyder, *Financial Standard,* 8 September 2016.

Revised definitions and disclosures

In essence, the revised RG 97 is looking to capture all fees and costs paid to third parties to generate the investment return, in addition to those paid to the product issuer by way of investment management and performance fees. Achieving this outcome required the amendment to and removal of key definitions in the Guide, along with the insertion of a number of new defined terms.

The most important definitions in the revised RG 97 are as follows (the full list of new definitions is detailed in Schedule 10 of the Corporations Act[3]).

Management costs

One of the key changes for superannuation products is the removal of the reference to "management costs" – instead the term "indirect costs" now incorporates management costs[4]. In addition, "indirect costs" captures all the costs of investing through an interposed vehicle[5] or a chain of interposed vehicles[6], regardless of whether the investment is listed or unlisted. The idea behind incorporating these costs under one general category of "indirect costs" is because of the previous Guide's inconsistent categorisation of transaction costs.

Indirect costs

Previously, the Guide's definition of indirect costs was somewhat open to interpretation. The redefined "indirect costs"[7] now captures any amount, not already disclosed as a fee or cost, that reduces (directly or indirectly) the return of a product or "the ultimate reference asset". Indirect costs must be quantified or reasonably estimated and disclosed. Performance fees and transactional and operational costs must be disclosed in more detail and on a full "look-through" basis to capture all underlying investment manager fees and costs. Indirect costs also include foreign exchange costs, OTC derivatives costs, leverage and borrowing costs and security lending costs at the investment manager level, and at the underlying investment manager level, if applicable. Indirect costs should capture embedded costs that may not be charged specifically as a fee.

Interposed vehicles

A new defined term "interposed vehicle" is a body, trust or partnership, meeting either an asset test or a PDS test and not excluded under a platform test. The costs associated with investing through interposed vehicles are indirect costs. ASIC has further clarified that the defined term is irrespective of an investment being listed or unlisted[8]. When calculating costs associated with investing through interposed vehicles, it is expected that the product issuer take reasonable steps to seek and follow-up on information from investment managers, considering materiality in the context of overall costs. What is reasonable will depend on the circumstances. In the event that information is not, or cannot, be provided, the product issuer should make a reasonable estimate and should maintain documents to support the approach taken and decision made.

3. Refer to Part 7.9 (PDS regime and shorter PDS regime) and Schedule 10, clauses 101-303 (enhanced disclosure regime) of the *Corporations Act Cth 2001* (Corporations Act).
4. RG 97.41 and Clause 102, Schedule 10, Corporations Act.
5. RG 97.54 - refer to Figure 1: Test for interposed vehicle (platform, asset and PDS test) on page 12 of this document.
6. RG 97.41.
7. Clause 101, Schedule 10, Corporations Act.
8. Australian Securities & Investment Commission, *Questions and answers – fees and costs disclosure – superannuation and managed investment products*, 20 October 2016 (FAQ 12).

Derivatives

The costs of some derivative products are indirect costs, such as counterparty remuneration, if applicable[9]. The rationale is that some derivative financial products not traded on a financial market are sometimes used in a manner similar to interposed vehicles (i.e. as a way of gaining synthetic exposure to an asset). For superannuation products, OTC derivative costs, including transactional and operational costs (and including when derivatives are used for hedging purposes), need to be included in investment fees or indirect costs[10]. ASIC does not require consideration of standard form derivative financial products that are able to be traded on a financial market.[11]

Transactional and operational costs

These costs include buy/sell spreads, brokerage and stamp duty amongst other cots[12]. The details of how these are disclosed should be consistent with the definitions in Schedule 10 of the Corporations Act, which product issuers should also use as guidance when including this information within the "additional explanation of fees and costs" section of a PDS. However, ASIC's recent guidance encourages issuers to include a total of the amounts for management costs and transactional and operational costs as a ratio, calculated on the same basis as an indirect cost ratio and determined in relation to the last financial year. This can be illustrated as a dollar figure by applying it to an example on the same basis as the example of annual fees and costs.

Performance fees

Performance fees must be disclosed as a management cost (now incorporated within indirect costs), which has been a requirement for some time. However, ASIC's new guidance is that the amounts disclosed will depend on to whom the performance fee is payable. Performance fees payable to the responsible entity must be disclosed based on the typical ongoing amounts that apply (i.e. those applying currently, and those intended to apply in the future) but can have regard to last year's performance fee[13].

Performance fees paid indirectly through an interposed entity, should be disclosed as investment fees unless the product issuer elects in writing to treat them as indirect costs[14]. Disclosed amounts must be disclosed based on the typical ongoing amount and these can be based on actual amounts paid during the previous financial year, but not on an average over historical years. Information about the material costs relating to performance in the additional explanation of fees and costs is encouraged.

Stamp duty

Any tax or stamp duty on the acquisition or disposal of an asset are disclosed as transactional and operational costs, forming part of indirect costs[15].

9. RG 97.102.
10. Australian Securities & Investment Commission, *Questions and answers – fees and costs disclosure – superannuation and managed investment products*, 20 October 2016 (FAQ 19).
11. RG 97.102.
12. The full list of transactional and operational costs is detailed in Clause 103, Schedule 10, Corporations Act.
13. RG 97.127 and RG 97.128
14. Australian Securities & Investment Commission, *Questions and answers – fees and costs disclosure – superannuation and managed investment products*, 20 October 2016 (FAQ 9).
15. RG 97.49 and RG 97.167.

Implementation for superannuation funds

The implementation of RG 97 will mean superannuation funds will almost certainly report a higher indirect cost ratio (ICR) and most will be required to change the methodology by which the fund ICR[16] is calculated, and which is provided to retail clients, and prospective retail clients, in the fund's PDS.

As noted above, the enhanced fees and costs disclosure is mandatory for any PDS issued in 2017 (by February or September, depending on the product issuer's elected compliance date) and for Periodic Statements provided on or after 1 January 2018. It is expected that superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) will have, or can easily acquire, sufficient information to know or to be able to reasonably estimate these fees and costs, to the level of detail prescribed in RG 97, as part of the fund's initial due diligence process prior to appointing an investment manager, or by making reasonable enquiries of existing investment managers.

ASIC intends to undertake compliance reviews, after the compliance dates, to check compliance with the RG 97 disclosure requirements. It is recognised though that there may be initial errors with data collection and interpretation, and ASIC has indicated that it will take a "facilitative" approach to 1 October 2017 with product issuers who have made a clear effort to comply, but that any funds that are deliberately "gaming" the RG 97 disclosure regime[17] will face appropriate enforcement action.

A complication in implementation and enforcement though is that RG 97 is very much a principles based approach to regulation in that what types of fees and costs to disclose is defined, but how superannuation funds report this is at their discretion. ASIC recognises that there is a wide variation in funds' circumstances, and that not all individual circumstances will be covered by RG 97.

Amounts to disclose

The disclosure of fees payable to the product issuer should be the typical ongoing amounts that apply (i.e. those applying currently and those intended to apply in the future). The disclosure of all other investment management costs (that are not fees payable to the issuer), including all indirect costs, should be based on the actual amounts paid in the previous financial year. For new products, the amounts disclosed should be based on the product issuer's reasonable estimate for the current financial year.

16. The management costs referred to above form part of the management expense ratio (MER) calculation, also referred to as the indirect cost ratio (ICR), which is what most superannuation funds currently compare when it comes to fees (even though there are other fees and costs for a retail client to consider). We will refer to the ICR throughout this paper to be consistent with the terminology now used in RG 97.
17. Australian Securities & Investment Commission, *Questions and answers – fees and costs disclosure – superannuation and managed investment products*, 20 October 2016 (FAQ 1).

What must the PDS include?[18]

- Disclosure of indirect costs and total fees and costs.
- A Consumer Advisory Warning[19] displayed at the beginning of the fees and costs section.
- A standardised fees and costs template (for each MySuper product and each Investment Option being offered).
- An example table of annual fees and costs for each Option being offered.
- Any additional explanation(s) of fees and costs as relevant to the superannuation product.
- A definition of fees for superannuation products (consistent with Schedule 10 of the Corporations Act – refer to Table 5 for full details).

Updating a PDS for changes in costs disclosed

Before the end of each financial year, ASIC expects product issuers to consider whether the cost disclosure based on the previous year's figures needs to be updated to ensure the PDS is up to date. If the difference is not materially adverse from the viewpoint of the “reasonable person” investor, the update may be provided by way of a website update, provided the conditions of ASIC class order 03/237 are met[20]. The cost of updating a PDS each year for cost information is considered to be an additional cost[21]. If the superannuation fund becomes aware of updated information relating to costs during the financial year, it should consider, based on the nature and materiality of those costs, whether it needs to reissue its PDS to avoid it becoming out of date, misleading or deceptive.

18. RG 97.10 and RG.97.11.
19. Specified example in Clause 221, Division 7, Schedule 10 of the Corporations Act.
20. RG 97.35 and ASIC Class Order 03/237, Updated information in product disclosure statements, 10 October 2007. “Materially adverse information” means 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.
21. However, the cost itself should not be a driver of the decision to issue an updated PDS.

Potential impact

ASIC's assumption is that improved disclosure of fees and costs, and the greater explicit transparency, should encourage more considered decision making behaviour by a superannuation fund, as trustees will likely have more regard to disclosed fees and costs when making decisions, predominantly investment decisions, for a fund.

ASIC expects superannuation fund ICR's to increase as a consequence of the enhanced disclosure regime, but that the greater transparency will reinforce consumer trust in the industry, and is an opportunity for superannuation funds to engage with members to explain why costs might be higher in particular options with varying objectives (different asset allocation and different return/risk targets).

One live and comparative market is that of the Netherlands, which is considered by some to now be the most fee transparent, and have the most rigorous cost-disclosures, in the world. The path to this position can be traced back to 2011 when the Netherlands Authority for the Financial Markets (AFM) released a report (in response to political pressure demanding legislation to capture and expose all investment fund costs) that found that "…many pension funds do not report all costs, in particular investment costs… The actual investment cost is on average two to three times higher than the reported costs…understanding the investment costs is necessary in order to assess investment performance"[22].

Stricter fees and costs reporting has now been mandated in the Netherlands, in particular for their pension funds, and the effect on calculated ICR-equivalents has been significant. The main objective was never one to simply lower costs but to improve discussions about costs and recognise that costs are often a by-product of the investment strategy and risk appetite. In recent years, UK and Swiss authorities too have been paying greater attention on improved cost transparency and disclosure. Swiss pension funds are achieving greater transparency through a requirement to disclose the total expense ratio (TER) to capture implicit transaction costs, amongst other things. Interestingly, in Switzerland, a pension fund with a provider (investment manager) who does not or will not report its TER must be named – effectively creating a "blacklist"[23].

Table 1: Asset management costs for Dutch pension funds

	Asset Management Costs 2004	Asset Management Costs 2009	Asset Management Costs 2011	Asset Management Costs 2012	Asset Management Costs 2014
Dutch Pension Fund Average	0.10% (no mandatory reporting - 26% of funds did not report investment costs)	0.30%	0.40%	0.44%	0.60% (including transaction costs of 0.08%)

Source: Bikker, DNB, CEM and LCP

22. Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten), *Pension schemes costs deserve more attention (Kosten pensioen-fondsen verdienen meer aandacht),* April 2011. Specified example in Clause 221, Division 7, Schedule 10 of the Corporations Act.
23. Barbara Ottawa, "Pensions in Switzerland: Cost wary could lose out", *IP&E Magazine*, December 2014.

According to CEM Benchmarking research, and as set out in the table above[24], in 2012 Dutch pension funds' ICR-equivalent on average was 0.44%. Post the legislative changes, the Dutch version of our ICR (inclusive of transaction costs) was 0.60%, an average increase of 0.16% post the implementation of the new reporting rules. Note too the relatively low ICRs in prior years, suggesting perhaps there was indeed significant underreporting of costs in earlier years and a number of funds that simply did not report investment costs prior to the requirement being mandated (and hence justifying AFM's conclusions in part). The same CEM Benchmarking survey found a higher allocation to fixed income and a lower allocation to equities by Dutch schemes, relative to other schemes in the global survey of 344 pension funds. Dutch schemes also had the largest relative allocation to property and commodities, and their allocation to hedge funds and private equity were reportedly the lowest. It has been observed that disclosure of costs did not reduce allocations to more expensive asset classes nor did it induce a decisive shift towards passive strategies; it did, however, appear to encourage more in-house asset management.

Obviously, Dutch pension funds are different to Australian superannuation funds and the legislation itself is different. However, the ICR adjustment post-legislation gives a guide as to the potential impact of RG 97 here as, inevitably, the Guide's wider definition of fees and costs will almost certainly increase the ICR for superannuation funds, albeit to varying degrees.

To date, very few superannuation funds have calculated their ICR based on the revised RG 97. A number of not for profit superannuation funds that have made some headway are anecdotally reporting a 0.15% to 0.25% upward impact on their ICR, a significant jump by any measure. It will be the beginning of 2018 before any concrete data will be available however, so any definitive conclusions will have to wait until then.

24. Leen Preesman, "Dutch pension funds achieve highest returns in world against lower costs", *IP&E Magazine*, 10 February 2014.

Superannuation fund disclosures required by the revised RG 97

The various components currently reported in a superannuation fund's ICR under the previous RG 97 did vary, mainly due to the ambiguity of the term "indirect costs" and how such costs should be calculated. As noted, in response, ASIC modified the definition of "indirect costs" in the revised RG 97 and ASIC has also clarified that, in calculating "indirect costs", superannuation funds should make a reasonable estimate where the exact cost is not known, or ought to be known[25].

What constitutes a "reasonable" estimate is not specifically detailed by ASIC; however, superannuation funds can rely on their existing knowledge of typical costs for a given type of asset or exposure as an estimate. Any steps taken should be considered in light of the materiality of the information. Information can be sought from operators of interposed vehicles, or obtained from other sources as appropriate[26]. Where there is a range of fees, ASIC cautions against adopting the lowest number in the range. Further, where an estimate is used, ASIC encourages disclosure of the basis of the estimate, although this is not mandatory.

Also to be included in a superannuation fund's PDS are the worked fee and cost template examples, the buy/sell spread, and any additional fees that the member may incur when withdrawing or switching funds. Currently, withdrawal and switching fees are commonly recorded as "nil" or "$0", which ASIC considers misleading.

The three biggest disclosure issues for superannuation funds to deal with under the revised RG 97 are therefore:

- The disclosure of "indirect costs"' and the "indirect cost ratio";
- Capturing costs of investing through "interposed vehicles"; and
- Calculating transactional, operational and OTC derivative costs.

While we note some variance in the level and types of fees that are currently disclosed under the previous RG 97, Table 2 provides an indicative summary of the types of fees and costs currently collected to satisfy APRA reporting for Form SRF 702.0 Investment Performance[27]. Table 3 outlines the required level of annual data collection to satisfy the revised RG 97 disclosure requirements.

25. Note that any amounts that are estimates should be clearly designated as an estimate.
26. Australian Securities & Investment Commission, *Questions and answers – fees and costs disclosure – superannuation and managed investment products*, 20 October 2016 (FAQ 7).
27. Australian Prudential Regulation Authority, *Reporting Standard SRS 702.0 Investment Performance*, September 2013.

Table 2: Fees and costs disclosures (September 2013 APRA form SRF 702.0)

Fees paid to investment manager [top level]	
Base/management fee (gross) *Base fee rebate*	Estimate or actual *If applicable*
Other management expenses (i.e. trustee/administration/other costs)	Estimate or actual
Performance fee (paid or payable) *Performance fee rebate*	Estimate or actual *If applicable*
Performance fee (accrued or not yet payable) *Performance fee rebate*	Estimate or actual *If applicable*
Fees paid to underlying investment managers [e.g. via fund of fund vehicles]	
Base/management fee (gross) *Base fee rebate*	Estimate or actual *If applicable*
Other management expenses (i.e. trustee/ administration/other costs)	Estimate or actual
Performance fee (paid or payable) *Performance fee rebate*	Estimate or actual *If applicable*
Performance fee (accrued or not yet payable) *Performance fee rebate*	Estimate or actual *If applicable*

As noted, the revised fees and costs disclosure regime in RG 97 aims to report on a full look-through basis, including details of all transactional and operational costs incurred.

Table 3: Revised fees and costs disclosures (November 2015 ASIC RG 97)

Management fee [same level of disclosure for the direct investment manager and all underlying investment managers on a full look-through basis as applicable]	
Base fee (gross) (include any rebate if applicable) Other management fees (including trust, administration costs) (include any rebate if applicable) Performance fee paid/carried interest realised (include any rebate if applicable) Performance fee (accrued or not yet payable) (include any rebate if applicable)	This information is already collected as part of the current reporting requirements to APRA (Form SRF 702.0)
Transactional and operational costs [same level of disclosure for the direct investment manager and all underlying investment managers on a full look-through basis as applicable]	
Transaction costs (on a full look-through basis) Operational costs (on a full look-through basis) Foreign exchange costs OTC derivative costs Leverage/borrowing costs Securities lending costs	These are the additional fees and costs required to be reported (on a full look through basis) as part of the revised RG 97

Indirect costs include (refer to Table 4 for a more detailed definition):

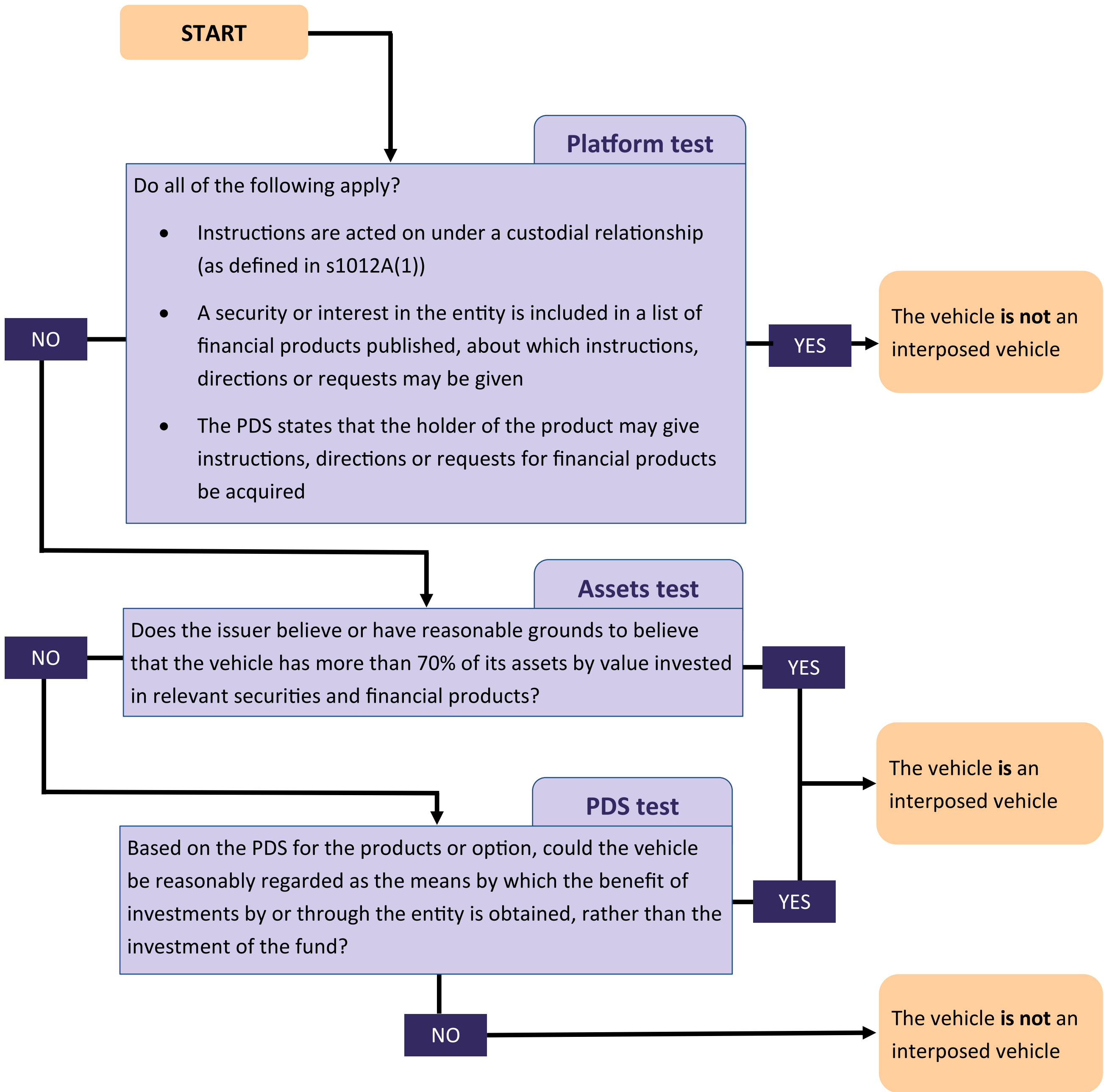
- Transactional and operational costs, as long as these costs are not a fee of the superannuation entity (for managed investment products, details of transactional and operational costs must be separately stated under "Additional explanation of fees and costs")[28];
- Any underlying management costs, on a full look-through basis, associated with an interposed vehicle;
- Any tax or stamp duty on the acquisition or disposal of an asset must be disclosed for a superannuation fund (but is not required for a registered scheme as these are considered by ASIC to be part of transactional and operational costs)[29];
- The buy/sell spread of OTC derivatives (the cost of gaining exposure to underlying assets); and
- If the product issuer elects to do so in writing, performance fees paid indirectly through interposed vehicles (distinct from fees relating to performance incurred by a superannuation fund trustee), reported based on the actual amount charged during the previous financial year (except for new products which are based on future estimates).

Disclosure of costs, other than for new investment options, are to be based on the actual amount from the previous financial year's outcomes[30]. A product issuer will need to consider, at the end of each financial year, if costs disclosed are materially different to the previous year so that the costs disclosed in the PDS are not misleading[31]. However, a prudent approach would be to consider this as the end of the financial year approaches to ensure the PDS remains up to date.

As noted, when disclosing fees and costs in a PDS, a product issuer must take into account the fees and costs of making both direct and indirect investments and the cost of investing in entities that fall within the definition of "interposed vehicles" per Figure 1.

28. RG 97.48.
29. RG 97.49.
30. RG 97.19.
31. RG 97.40 (If the difference is not materially adverse from the viewpoint of the investor, the product issuer can make the update by releasing the new information in a way permissible under CO 03/237 – see RG 97.35 - RG 97.39).

Figure 1: Test for interposed vehicle (platform, asset and PDS test)



Source: RG 97.

Superannuation funds that do not include the costs involved with investing in interposed vehicles will not be considered to be compliant, unless, the product issuer elects in writing to treat them as fees[32].

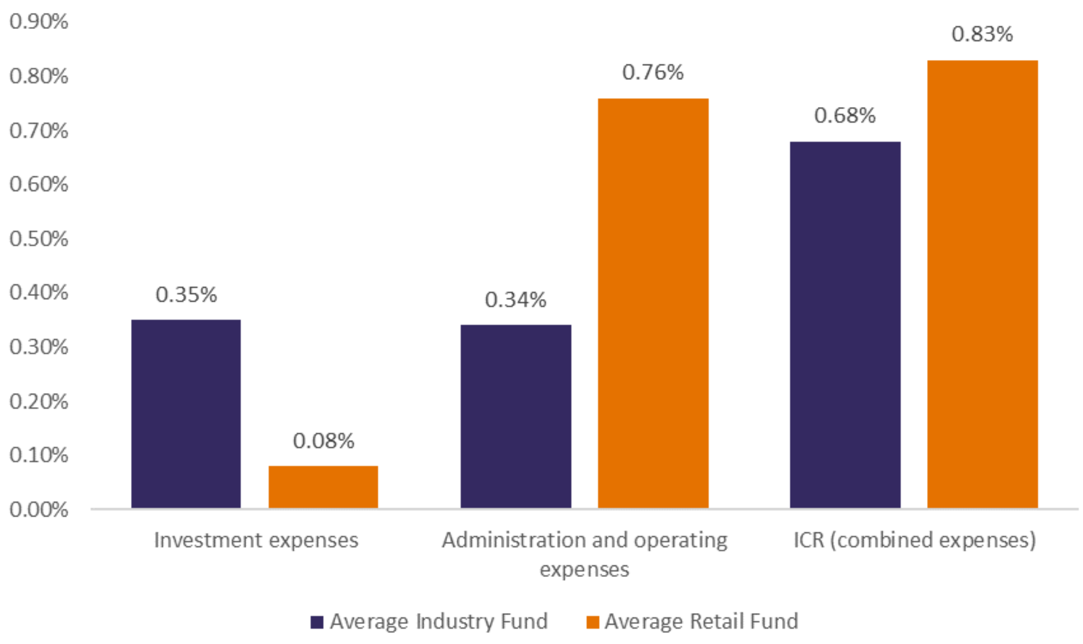
32. RG 97.94.

Competitive and investment effects

Reporting of fees and costs data has been a part of the superannuation sector for some time, although as noted by ASIC (and APRA), consistency is poor and comparability therefore low. By way of example, Chart 1 presents some quasi ICR calculations based on reported APRA data. Ostensibly accurate and comparable, there is however a wide variety of calculation methods and methodologies inherent in the data, leading to aggregates and averages that are probably not that usable.

Of particular note are the reported "investment expenses" for the average retail fund: unless these are all managed passively, these expenses are clearly too low and not capturing the type of information that the revised RG 97 will. Similarly, the administration and operating expenses incurred by the average industry and retail fund differ by more than might be expected and this may also be an area where there is some change.

Chart 1: Retail versus Industry superannuation fund ICR comparison



1. Data above is based on the year end to June 2016 and is based on information supplied to APRA (subject to rounding).
2. Industry fund and retail superannuation fund data is based on entities with more than four members.
3. "Investment expenses" are defined by APRA as all expenses which are associated with the generation of income on the investment portfolio of the superannuation entity.
4. "Operating expenses" are defined by APRA as expenses incurred which are not ordinarily directly associated with the generation of investment income (i.e. expenses that are not directly related to the investment portfolio of the superannuation entity, but more toward the administration of the superannuation entity). "Administration expenses" represent expenses that relate to the administration or operation of the fund.
5. The ICR (combined expenses) includes fees and costs identified as "investment expenses", "operating expenses" and "administration expenses". This is for illustrative purposes only: we note for example that the ICR would not include Administration expenses under the revised RG 97 PDS disclosure requirements.
6. Source: Australian Prudential Regulation Authority, *Quarterly Superannuation Performance*, June 2016 edition (issued 23 August 2016).

The revised RG 97 is designed to remove most of the issues that are present in the above data. However, it is yet to be seen how successful the requirements contained within the new Guide will be, and whether the lack of true comparability due to inconsistent approaches taken by the industry will be rectified.

The new RG 97 impacts the common investment sectors differently though, and impacts the various investment structures very differently as well[33]. There may be some investment sectors where fees and costs are unchanged, or in some cases even reduced, though this will be partially offset by investments in some of the more expensive sectors, such as real assets. Similarly it is expected, irrespective of the investment sector, that fees and costs associated with direct investments are broadly well disclosed already relative to indirect investments and investments in OTC (non-traded) financial products, which are typically more opaque in nature.

We noted earlier that we expect not for profit superannuation funds to see a material ICR increase post implementation of the new rules, and this is supported by early analysis of likely changes by some funds themselves. What is less clear at this time is the impact on the retail/for profit sector. Notwithstanding some of the issues with the underlying data, Chart 1 shows that there was a 0.15% overall difference in ICR between the average industry fund and the average retail fund in the year to June 2016. So far, it seems that the average industry fund will disclose an additional 0.15% to 0.25% which will neutralise the difference if there are no changes to retail disclosures. However, this seems unlikely based on the underlying numbers supporting Chart 1 so it is probable that the not for profit sector will retain its overall cost advantage with the new disclosure requirements, and it is indeed possible that this advantage could widen depending on the changes in disclosures by retail funds.

The enhanced fees and costs disclosure requirements will be initially cumbersome for most superannuation funds, however we think it is important not to lose sight of the fact that the changes are a disclosure and reporting issue and should not drive a fund's investment strategy. The common example here is the potential for a reconsideration of investments in real assets and other private or niche strategies, which often have higher transactional and other costs that are now captured by RG 97 and so will push up the ICR. However, we continue to believe that the focus should be on net returns as well as the overall achievement of the objectives set, within an overarching framework of value for money and alignment of interest.

Increased transparency and the ability to more accurately compare costs is positive for funds and their members, and hopefully will further shift the balance of economics in favour of the investor. Improved disclosure should also facilitate funds in negotiating better terms and in making more informed decisions. What will be a challenge though is the communications effort involved in the likely higher ICR to be disclosed to members and the market, not to mention the lower forecast net returns and the lower final benefit payment forecasts therefrom. Fortunately, those issues are for member communications experts at superannuation funds to ponder.

"We continue to believe that the focus should be on net returns as well as the overall achievement of the objectives set, within an overarching framework of value for money and alignment of interest."

33. By way of example, Frontier reviewed some listed property fund ICRs under the various interpretations of RG 97 and other rules currently used (which differ). The analysis uncovered a stated ICR ranging from 0.32% to 0.94%, while the exact same listed property funds using full look-through disclosure principles uncovered an ICR ranging from 0.62% to 1.14%. It will be interesting to see where these ICRs finally fall in a correct application of the revised RG 97 in 2017.

Frontier's automated RG 97 solution

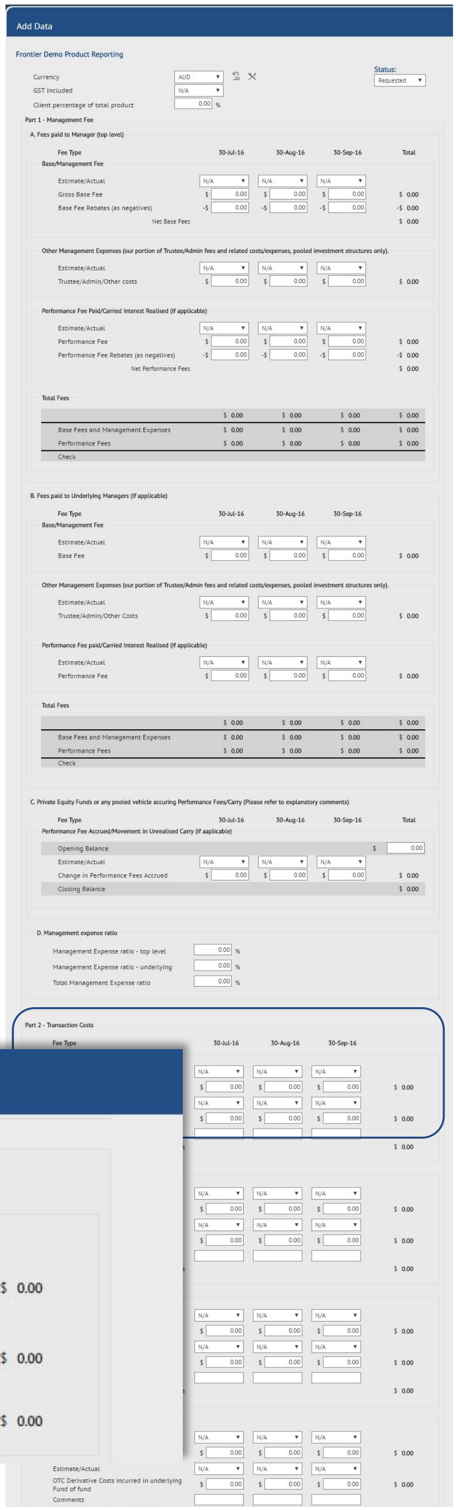
In response to the challenge facing our superannuation fund clients in implementing the revised RG 97, Frontier has developed a technology-driven solution to provide an efficient and effective means of requesting, collecting and reporting the required data from investment managers.

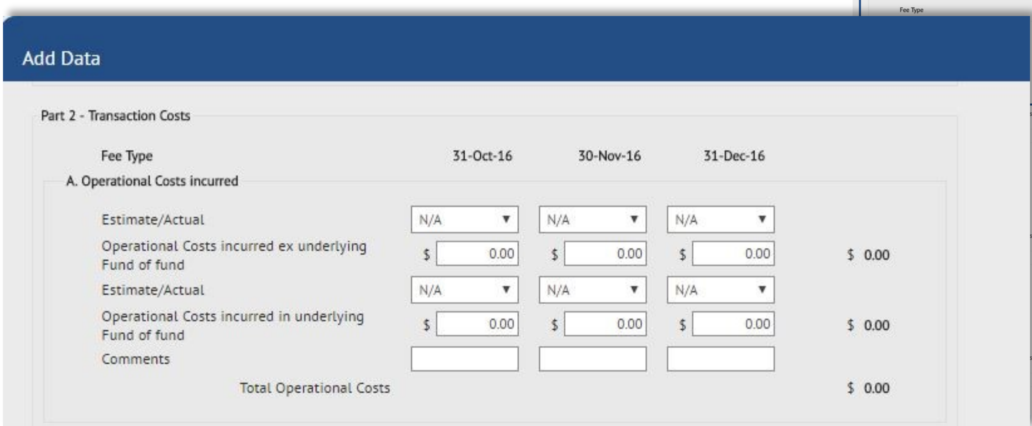
The technology is part of our award winning Partners Platform, one system of which is Mercury, a proprietary research and data portal covering an extensive universe of investment management firms and products. Mercury also includes a range of compliance and reporting tools which are populated directly by investment managers. Data are securely housed and dynamically updated, saving users considerable time and effort in the ongoing task of requesting, collecting and collating information from each investment manager in their various portfolios. Importantly, the My Reporting Module can satisfy the requirement for superannuation funds to document and support the approach taken in calculating fees and costs and complying with ASIC's requirements.

The new RG 97 functionality in Mercury automates the data request and collection process based on a complete, all in one fees and costs disclosure template (Figure 2). Importantly, the template also captures the data required for APRA's Form SRF 702.0. The system generates email requests to each required investment manager that uses the Mercury portal to complete a data entry feed. The data is then collated and managed, can be reviewed, and an aggregate report generated.

This new My Reporting Module is available now from Frontier, including for demonstration.

Figure 2: The My Reporting Module RG 97 template





Appendix

Table 4: Indirect costs

Definition	Application	Calculation
An indirect cost is defined as any amount that: a) a trustee of the entity or responsible entity knows, or reasonably ought to know or, where this is not the case, may reasonably estimate, will directly or indirectly reduce the return on the product or option that is paid from or reduces the amount or value of: i) the income of or the property attributable to the product or option; or ii) the income of or property attributable to an interposed vehicle in or through which the property attributable to the product or option is invested; and b) is not charged to the member as a fee; and c) is not a fee under section 29V of the SIS Act.	It is anticipated that APRA regulated funds should have, or can access, sufficient information to know or to be able to make a reasonable estimate of indirect costs (estimates should be clearly designated as an estimate). Indirect costs should capture: i) costs of deriving a return, including any costs incurred by investing through inter-posed vehicles; and ii) costs of gaining exposure to underlying assets by entering into derivative financial prod-ucts.	Having determined which entities are interposed vehicles, product issuers must: i) identify indirect costs they know or ought to know; and ii) reasonably estimate any indirect costs when it is not reasonable to know the cost. Fees disclosed are those applying currently and those intended to apply in the future. For existing products, the indirect cost amounts should be calculated based on the indirect costs paid in the previous financial year. Estimates may be required, for example, due to unavaila-bility of information about amounts of costs incurred for the last quarter of the financial year. Where any estimations are used (particularly when multiple approaches could be used) the issuer should consider including an explanation of the approach taken to the calculation and set out in "Additional explanation of fees and costs". If the issuer has grounds to believe the outcomes of previous financial years are not truly reflective of typical ongoing costs, this is encouraged to be noted in "Additional explanation of fees and costs". If reasonable to do so, a forecast of expectation may be appropriate.
The ICR for a MySuper product or an investment option offered by a super-annuation entity is the ratio of the total of the indirect costs for the MySuper product or investment op-tion to the total average net assets of the superannuation entity attributed to the MySuper product or investment option.		For existing products the ICR should be calculated based on the total average net assets for the relevant financial year.

Table 5: Fee definitions for superannuation products

The following definitions, other than insurance and performance fees, must be included under the heading “defined fees”[34]. Note that “management costs” no longer apply to superannuation products[35]; however, “management costs” still apply to managed investment products. For superannuation products “management costs” are incorporated into “indirect costs”[36].

Type of Fee or Cost	Description	Approach to Estimating
Activity Fee	(a) The fee that relates to costs incurred by the trustee, or the trustees, of a superannuation entity that are directly related to an activity of the trustee, or the trustees: i) that is engaged in at the request, or with the consent, of a member; or ii) that relates to a member and is required by law. (b) Those costs that are not otherwise charged as an administration fee, an investment fee, a buy-sell spread, a switching fee, an exit fee, an advice fee or an insurance fee.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Administration Fee	A fee that relates to the administration or operation of a superannuation entity and includes costs incurred by the trustee, or the trustees, of the entity that: (a) relate to the administration or operation of the fund; and (b) are not otherwise charged as an investment fee, a buy-sell spread, a switching fee, an exit fee, an activity fee, an advice fee or an insurance fee.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Advice Fee	(a) The fee that relates directly to costs incurred by the trustee, or the trustees, of a superannuation entity because of the provision of financial product advice to a member by: i) a trustee of the entity; or ii) another person acting as an employee of, or under an arrangement with, a trustee or trustees of the entity. (b) Those costs that are not otherwise charged as an administration fee, an investment fee, a switching fee, an exit fee, an activity fee or an insurance fee.	The issuer must use the highest fee or cost if there is a range of fees or costs.

34. Clause 209A, Schedule 10, Corporations Act.
35. RG 97.41.
36. Altered by ASIC Class Order 14/1252, *Explanatory statement*, December 2014.

Buy-Sell Spread	A fee to recover transaction costs incurred by the trustee, or the trustees, of a superannuation entity in relation to the sale and purchase of assets of the entity.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Exit Fee (Formerly Termination Fee)	A fee to recover the costs of disposing of all or part of members' interests in a superannuation entity.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Insurance Fee	(a) The fee relates directly to either or both of the following: i) insurance premiums paid by the trustee, or the trustees, of a superannuation entity in relation to a member or members of the entity; and/or ii) costs incurred by the trustee, or the trustees, of a superannuation entity in relation to the provision of insurance for a member or members of the entity. (b) The fee does not relate to any part of a premium paid or cost incurred in relation to a life policy or a contract of insurance that relates to a benefit to the member that is based on the performance of an investment rather than the realisation of a risk. (c) The premiums and costs to which the fee relates are not otherwise charged as an administration fee, an investment fee, a switching fee, an exit fee, an activity fee or an advice fee.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Indirect Cost Ratio	For a MySuper product or an investment option offered by a superannuation entity, this is the ratio of the total of the indirect costs for the MySuper product or investment option to the total average net assets of the superannuation entity attributed to the MySuper product or investment option. NB: A dollar-based fee deducted directly from a member's account is not included in the indirect cost ratio.	Based on actual amounts from the previous financial year (except for new products).
Investment Fee	A fee that relates to the investment of the assets of a superannuation entity and includes: (a) fees in payment for the exercise of care and expertise in the investment of those assets (including performance fees); and (b) costs incurred by the trustee, or the trustees, of the entity that: i) relate to the investment of assets of the entity; and ii) are not otherwise charged as an administration fee, a buy-sell spread, a switching fee, an exit fee, an activity fee, an advice fee or an insurance fee.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Performance Fee	Amount paid or payable, calculated by reference to the performance of a managed investment product, a superannuation product, a MySuper product or an investment option.	The issuer must use the highest fee or cost if there is a range of fees or costs.
Switching Fee	A fee to recover the costs of switching all or part of a member's interest in a superannuation entity from one class of beneficial interest in the entity to another.	The issuer must use the highest fee or cost if there is a range of fees or costs.

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