

**ASIC CLASS ORDER [CO 14/1252]  
EXPLANATORY STATEMENT**

Prepared by the Australian Securities and Investments Commission  
*Corporations Act 2001*

The Australian Securities and Investments Commission (*ASIC*) makes Class Order [CO 14/1252] under paragraph 1020F(1)(c) of the *Corporations Act 2001* (the *Act*).

Paragraph 1020F(1)(c) of the Act provides that ASIC may declare that Part 7.9 of the Act applies in relation to a person or a financial product, or a class of persons or financial products, as if specified provisions were omitted, modified or varied as specified in the declaration.

## **1. Background**

Relevantly, Schedule 10 to the *Corporations Regulations 2001* (the *Regulations*) sets out requirements for the disclosure of fees and costs of superannuation and managed investment products in Product Disclosure Statements and in periodic statements that must be given to members.

## **2. Purpose of this class order**

Since the introduction of Schedule 10 in 2005 as a result of the enhanced fee disclosure law reforms, complexity of superannuation and managed investment products offered has increased, in particular in relation to investment and operational structures. In conjunction with increased complexity, industry disclosure practices have also evolved over the years that lead to some under-disclosure of fees and costs in some instances.

In 2013/14 ASIC undertook a review of industry fee and cost disclosure practices. A key finding of this review was that some industry participants were adopting various interpretations of Schedule 10, in particular the interpretation of indirect costs for superannuation products and of management costs for managed investment products. For example some products issuers have taken the view that the regulations do not require costs associated with investing through interposed vehicles to be included in their product's indirect costs or management costs. This is despite the stated intention of the regulations as set out in the relevant Explanatory Statement to require these costs to be disclosed.

Stronger Super reforms introduced from 1 July 2013 included a number of amendments to the regulations. Some of the amendments caused unintended inconsistencies in terminology between Schedule 10 and Schedule 10D and 10E to the Regulations that apply to short form superannuation Product Disclosure Statements and managed investment Product Disclosure Statement respectively. The Stronger Super reforms also included some minor drafting anomalies that could be interpreted in a way that does not reflect the intention with which they were made.

The purpose of this class order is to revise some of the definitions, including the indirect cost and management cost definitions and to clarify the costs that must be disclosed consistently with the intended effect of Schedule 10 to the Regulations. The class order also addresses

some provisions that could be interpreted in an anomalous way that were included in the Regulations as part of the Stronger Super reforms. For example, one interpretation of the regulations was that, prior to being amended by this class order, they required trustees to double count some costs in some circumstances.

The class order provides a transition period to allow issuers to update their systems and procedures to comply with the amendments.

### **3. Operation of this class order**

[CO 14/1252] modifies or varies Part 7.9 of the Act as it applies in relation to managed investment and superannuation products as if provisions of that Part are modified or varied by the class order.

Paragraph 5 of the class order modifies section 1013C of the Act so that issuers must include information in their Product Disclosure Statement that is known to them unless otherwise provided in the regulations. This modification ensures that Schedule 10 is able to include requirements for issuers to disclose information that they can reasonably estimate or determine.

#### **Interposed Vehicle**

Subparagraph 6(a) inserts a definition of “interposed vehicles” in relation to a MySuper product, an investment option offered within a superannuation product other than a MySuper product, a managed investment product or an investment option offered by a managed investment scheme in paragraph 101 of Schedule 10 of the Regulations. Interposed vehicle under this paragraph means a body, trust or partnership other than a body, trust or partnership to which subparagraphs (a) or (b) of the definition applies.

Under subparagraph (a) a body, trust or partnership is not an interposed vehicle if it is one that does not predominantly carry on a business of investment in securities or financial products, such as a managed investment scheme that invests directly in property, provided that this body, trust or partnership is also included in the official list of a prescribed financial market or of a financial market operated outside of this jurisdiction that is regulated by a foreign government or an agency of a foreign government. This means, for example, that a managed investment scheme that invests directly in property will not be an interposed vehicle if it is listed on a prescribed financial market, such as the ASX.

A body, trust or partnership listed on prescribed financial market or offshore regulated market that predominantly carries on a business of investment in securities or financial products is typically invested in as a means of gaining exposure to other assets. Such a listed body, trust or partnership would be an interposed vehicle because it is a means of investing in securities or financial products. Examples of this type of interposed vehicle include listed investment companies and quoted and listed managed investment schemes, such as index funds that are exchange traded funds.

Further, under subparagraph (a) a body trust or partnership that does not predominantly carry on a business of investment in securities or financial product is not an interposed vehicle if

having regard to each Product Disclosure Statement (PDS) for the product or option, a security or interest in the body, trust or partnership is reasonably regarded as the investment of the superannuation entity or registered scheme to which the product or option relates, rather than the means by which the benefit of investments by or through the body, trust or partnership is obtained. This means, for example, that a managed investment scheme that invests directly in property will not be an interposed vehicle if the PDS for the product or option that invests in this scheme makes it clear that the scheme is the investment, and that the value of the investment depends on how the scheme is managed and does not refer to the current or expected particular assets that are to be held in the scheme in a way that could result in it being viewed as a means of obtaining exposure to those assets.

Subparagraph (b) addresses the circumstances under which a body, trust or partnership that is offered as an investment option or product through a platform type arrangement, including investor directed portfolio services and similar platforms, is not an interposed vehicle. The subparagraph provides that a body, trust or partnership is not an interposed vehicle if the PDS for the product or investment option states that a holder of the product may give instructions, directions or requests for financial products that have been published in a list by the responsible person for the PDS to be acquired and the responsible person for the PDS has published a list of financial products in relation to which the instructions, directions or requests may be given as stated in the Statement which includes a security or interest in the body, trust or partnership. This exclusion applies where the arrangement under which the instructions would be acted on is a custodial arrangement as defined in subsection 1012IA(1) of the Act.

### **Switching Fee**

Subparagraph 6(a)(iii) of the class order modifies the definition of *switching fee* in Schedule 10 so that, for a MySuper Product, it has the meaning given by subsection 29V(5) of the *Superannuation Industry (Supervision) Act 1993* (the *SIS Act*). For a superannuation product other than a MySuper product, a switching fee means a fee to recover the costs of switching all or part of a member's interest in the superannuation entity from one investment option or product in the entity to another. For a managed investment product a switching fee means an amount paid or payable when a product holder transfers all or part of the product holder's interest in the managed investment scheme from one investment option to another.

### **Indirect Costs**

Subparagraph 6(a)(iv) of the class order inserts a new clause 101A into Schedule 10 which in effect modifies the definition of *indirect costs*. The modified indirect cost definition applies to superannuation trustees of entities offering a MySuper products and superannuation products other than MySuper products. It also applies to responsible entities of registered schemes. Its application to responsible entities of registered schemes is to ensure that indirect costs associated with investing through interposed vehicles, other than any exclusions allowed for by Schedule 10 such as transactional costs, are included in schemes' management costs.

An indirect cost under the new clause means any amount that a trustee of a superannuation entity or a responsible entity:

- knows or reasonably ought to know or,
- where this is not the case, may reasonably estimate;

that will directly or indirectly reduce the return on the product or option that is paid from or reduces the amount or value of the income of or property attributable to the product or option or the income of or property attributable to an interposed vehicle in or through which the property attributable to the product or option is invested.

For example, a superannuation fund invests in term deposits and other cash investments by acquiring a life product from a life insurance company that makes these investments. The superannuation fund trustee will need to include in the fund's indirect costs the amount deducted from the income earned on the term deposits and other cash investments, including any amount deducted by the life insurance company from the income. Any amount that is charged to a member as a fee or, for superannuation products, is a fee under section 29V of the SIS Act is not an indirect cost.

Notional paragraph 101A(2)(a) makes it clear that where property is invested through a chain of interposed vehicles, costs incurred by each of the interposed vehicles are to be taken into account. For example, an investment in securities, such as shares or bonds, that is held through multiple layers, such as fund of funds structure, would still be regarded as property for the purposes of calculating the indirect costs of investing in those securities.

Conversely, notional paragraph 101A(2)(b) makes it clear that it is not necessary to take into account the costs imposed at the level of any vehicle through which a body, trust or partnership that is not of itself an interposed vehicle invests. For example, if a superannuation product invests in a listed company that is not an interposed vehicle and this company invests in another vehicle such as an investment trust then the costs of this downstream interposed vehicle will not be taken into account by the issuer of the superannuation product for the purposes of disclosing the product's costs in the PDS.

The indirect cost of a product or option includes an over the counter (OTC) derivative buy-sell spread. The buy-sell spread is the amount that would be required to acquire the derivative at the relevant time exceeds the amount that would be obtained on its disposal at that time attributable to the product or option or an interposed vehicle through which the property attributable to the product or option is invested. Derivatives that are not traded on a financial market (OTC derivatives) are sometimes used in a similar manner to interposed vehicles, that is to gain ongoing economic exposure to movement of particular assets, such as commodities, as part of the product issuer's investment strategy to meet the product or investment option's investment objective. The buy-sell spread will include the costs of the counterparty managing the exposure. It is therefore important that the buy-sell spread of OTC derivatives is included in the indirect costs of the product or investment option.

The indirect costs of a managed investment product or an investment option of a registered scheme does not include the buy-sell spread and any other costs associated with the acquisition or disposal of an OTC derivative where the derivative is acquired or disposed of for the primary purpose of avoiding or limiting the financial consequences of fluctuations in, or in the value of, receipts or costs of the managed investment scheme (hedging). This is the case regardless of whether the property is held or invested through an interposed vehicle. Any buy/sell spread and other costs of an OTC derivative that are excluded from the indirect cost of a managed investment product or an investment option of a registered scheme because of the OTC derivative was acquired or disposed for the purposes of hedging are likely to be

transaction costs under clause 102 of Schedule 10. Transaction costs are included in indirect costs for superannuation products and investment options.

Subparagraph 6(b)(i) of the class order modifies paragraph 102(1)(h) of Schedule 10 by including indirect costs in the definition of *management costs*. This modification avoids any doubt that indirect costs, as modified by the class order, will need to be included in the calculation of the management costs.

Subparagraph 6(b)(ii) of the class order modifies paragraph 102(2)(b) of Schedule 10 to exclude from the transactional costs and operational costs, which are not management costs for a managed investment product, any buy/sell spread of an OTC derivative included in the indirect cost under notional paragraph 101A.

Subparagraph 6(b)(iii) of the class order modifies paragraph 102(2)(h) of Schedule 10 to exclude from costs, which are not management costs for a managed investment product, any costs (related to a specific asset, other than a right or holding in an interposed vehicle, or activity to produce income) that an investor would incur if he or she invested directly in the asset. The effect of the amendment is to ensure costs in interposed vehicles are not excluded from management costs on this basis.

Subparagraph 6(c) of the class order omits the reference to insurance costs from the template for setting out information about a multiple fee structure for managed investment products under clause 202 of Schedule 10.

Subparagraph 6(d) of the class order omits the reference to insurance costs from the template for setting out information about a single fee structure for managed investment products under clause 202A of Schedule 10.

Subparagraph 6(e) of the class order omits paragraph 209(m) of Schedule 10. This paragraph is not required for superannuation products from 1 July 2013 as a result of the abolishment of member protection rules.

Subparagraph 6(f)(i) of the class order modifies paragraph 209A of Schedule 10 by substituting "fees" with ""fees", or incorporated by reference;". This modification is to allow trustees of superannuation entities to incorporate by reference the fee definitions set out in clause 209A of Schedule 10 in rather than set them out in the Product Disclosure Statement.

Subparagraph 6(f)(ii) of the class order modifies clause 209A of Schedule 10 by omitting the current switching fee definition and replacing it with the switching fee definition in relation to superannuation products inserted by subparagraph 6(a)(iii) of the class order.

Subparagraph 6(g) of the class order omits the consumer warning in clause 221 of Schedule 10 and replaces it with separate warnings for superannuation and managed investment products.

Subparagraph 6(h) of the class order omits paragraph 222 of Schedule 10 of the Regulations and replaces with a new paragraph that requires that the Consumer Advisory Warning referred to in paragraph 221(1) of Schedule 10 of the Regulations must be located at the beginning of the fees section of the Product Disclosure Statement for superannuation products and the Consumer Advisor Warning referred to in subclause 221(2) of Schedule 10

of the Regulations must be located at the beginning of the fees section of the Product Disclosure Statement for managed investment products where fees or costs may be deducted from amounts to be held for members of the managed investment scheme.

Paragraph 7 of the class order omits "termination fee" in subclause 8(3) of Schedule 10E to the Regulations and substitute it with "exit fee".

### **Transitional**

Paragraphs 8 provides that paragraphs 4 to 7 of the Class Order apply from 1 January 2016 in relation to a PDS unless the PDS states that the Class Order applies.

Section 1017D of the Act prescribes the period in which a periodic statement must be given to investors. The timing for the giving of periodic statements for superannuation products that are exit statements is affected by Subdivision 5.12 of Part 7.9 of, and Part 11 of Schedule 10A. Paragraph 9 provides that paragraphs 4 to 7 applies in relation to a periodic statement that is required to be given in accordance with section 1017D of the Act if the outer limit for giving the statement is on or after 1 January 2017, unless the periodic statement states that this instrument applies to it.

### **4. Consultation**

Consultation was carried out on an earlier draft of the class order with relevant industry associations and some superannuation and managed investment product issuers. This was followed by a more extensive consultation on an enhanced draft of the class order on 24 September 2014. The consultation was carried out by providing a draft of the class order with a background paper to all key industry associations, a number of superannuation and managed investment product issuers and a consumer organisation. We also issued a media release inviting interested parties to contact ASIC for a copy of the class order, if they wish to consider and provide feedback. The draft class order and background paper were provided to a further number of law firms, compliance professionals and superannuation and managed investment product issuers who requested a copy to consider and provide feedback.

ASIC received 19 responses to the draft class order from lawyers, industry bodies, superannuation trustees, responsible entities and compliance specialists. The class order was further revised and transition period extended in light of the submissions made.

The Office of Best Practice Regulation has agreed with ASIC's assessment that the class order will have a minor and machinery impact and therefore no Regulation Impact Statement is required.

## **Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

### **ASIC Class Order [CO 14/1252]**

This class order is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

#### **Overview of the class order**

Relevantly schedule 10 to the *Corporations Regulations 2001* sets out requirements for the disclosure of fees and costs of superannuation and managed investment products in Product Disclosure Statements and in periodic statements that must be given to members. The Class Order modifies those requirements to ensure that they have their intended effect, particularly in relation to the disclosure of costs that are incurred as a result of investing through interposed vehicles.

The class order was developed in consultation with industry and takes into account the submissions received.

#### **Human rights implications**

This class order does not engage any of the applicable rights or freedoms.

#### **Conclusion**

This class order is compatible with human rights as it does not raise any human rights issues.