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By email

Dear Darren

ASIC Regulatory Guide RG97 fees and costs disclosure

The Property Council and Property Funds Association welcomes the review of RG97 and the opportunity to provide further comments, following our meetings with you in late January.

Overview

We appreciate the significant efforts that have been taken by ASIC to develop the RG97 disclosure requirements and support ASIC's objective of greater transparency for consumers. We strongly support the review of RG97 to ensure the information being provided to retail investors is meaningful and assists with their decision making.

Our primary concern relates to the direction adopted in RG97 with regards to fees and costs disclosure at the asset level when a superfund or managed investment scheme (MIS) invests, either directly or indirectly, in property.

Property is seen as an essential part of a balanced and diversified investment portfolio, generating stable returns for investors. As a result, there are 14.8 million Australians with a stake in property through their superfunds, and many also invest directly in property MIS. This investment underpins Australia's commercial property market, including world class office buildings, industrial precincts and shopping centres. There is also a growing push to encourage superfunds to invest and support social and affordable housing to alleviate Australia's housing affordability challenges.

Critically, the current RG97 disclosures will put all this at risk. The differing treatment of property compared to other asset classes (for example, investment in equities, infrastructure and private equity) could lead to misleading information for retail investors which would then result in sub-optimal investment decisions. This is because:

- The disclosure of asset level expenses for property investments (which are not required to be disclosed for non-property investments) overinflates the costs actually incurred by investors, for example, most property operating costs are typically recoverable from tenants, these costs are incurred regardless of how the asset is owned and costs of this nature are also incurred in respect of other classes but are not required to be disclosed.
- These artificially overstated costs could lead superfunds and retail investors in MIS to reduce their exposure to property investments by divesting current holdings or allocating future investment decisions towards other asset classes which are not required to disclose asset level operating costs as part of the RG97 disclosure requirements. The heightened focus on fees and costs causes investment decisions to be made solely or predominantly on the basis of these fee

disclosures, without proper regard for the risk adjusted returns or benefits from holding a diversified investment portfolio.

These adverse implications can be easily addressed by adopting a policy framework that provides for an asset and investment method neutral approach, while still achieving the aims of transparency and comparability for retail investors.

Policy aims currently not being met

We understand the RG97 reforms are intended to develop better fee and cost disclosures to improve the transparency and comparability of fees and costs for superfunds and MIS, and we are supportive of this general premise.

Unfortunately, the current framework is not meeting these objectives due to the overly complex nature of the policy settings, and the different approach taken for property compared to other asset classes (many of which are also land rich). This has created significant uncertainty as each entity seeks to balance providing meaningful disclosures for their investors, with the technical challenges and lack of clarity set out in the regulations and ASIC's guidance.

This has particularly been the case as a result of the MySuper changes which replaced "management costs" with "indirect costs". Previously, fee disclosures under the "management costs" requirements were limited to those costs which an investor would not necessarily incur if they invested directly in the underlying investment. The shift to "indirect costs" now requires disclosure of any amount that will reduce the return on investment of an investor and which are not charged to the investor as a fee. This has led to complex definitions and tests on what is "the end investment" and resulted in different disclosure outcomes for property (where the property itself is treated as "the end investment") compared to other asset classes (where the asset is not treated as "the end investment").

Industry is of the view that the former rules, which required the disclosure of costs which an investor would not necessarily incur if they invested directly in the underlying investment, provided a fairer outcome across asset classes, while also providing sufficient transparency for retail investors on the investment-related management costs being incurred. This approach to disclosure would be industry's preferred approach because it achieves the desired policy outcomes without the unintended consequences of treating one asset class differently to another.

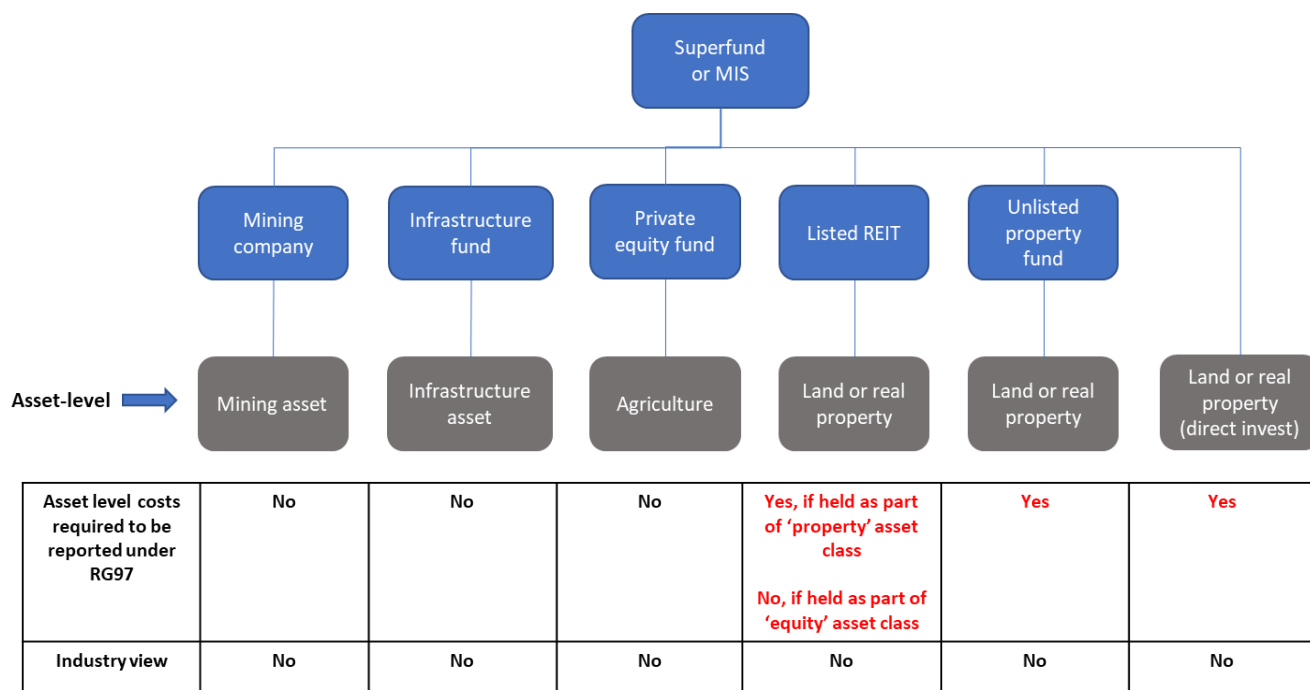
We understand from our meeting that the legislative framework is outside the scope of your review, and therefore, the remainder of this submission focuses on RG97 and the associated ASIC guidance materials.

Current disclosure of asset level costs is not meaningful information for retail investors

Set out below is our understanding of the comparative asset level fee and cost disclosure requirements for different asset classes under RG97 where the underlying property is viewed as the end investment¹. Asset level costs includes operating costs such as electricity, land tax, council rates, cleaning costs and property management costs. For MIS, the indirect costs calculation also captures borrowing costs which is another asset level cost.

¹ The diagram is not an exhaustive list of all investment types. For example, a superfund or MIS investing in listed equities directly or through an equities or index fund is not required to look through and disclose the asset level costs of the underlying equities.

Effectively, disclosure of asset level costs is required for most forms of property investment, but not for investments in other asset classes.



Disclosing asset level costs for property investments is not meaningful and could be misleading for investors because it overinflates the costs actually incurred by these investors. This is because:

- most property operating costs are typically recoverable from tenants. A significant proportion of the operating costs of properties are not borne (directly or indirectly) by the investors in the property fund. This is due to many of these operating expenses being on-charged to tenants of the property, either directly or via gross lease arrangements.
- when a superfund or MIS invests in listed or unlisted property funds, the investment is in the property fund itself, and not directly in the underlying asset. The asset level costs are already accounted in the return received – that is, the superfund or MIS receives a share of the property funds' net profit, being revenue less costs.
- these costs are incurred regardless of how the asset is owned, and the owner or manager of the asset often has limited or no ability to influence the amount of these costs, particularly where these are set by government or statutory authorities (for example, council rates, land tax, regulated charges for utilities and waste etc).
- costs of this nature are also incurred in respect of other asset classes, but these are not required to be disclosed for those asset classes (for example, an airport within an infrastructure fund or an agricultural investment through a private equity investment vehicle will have similar operating expenses).

The requirement to disclose asset level costs is also inconsistent with a layperson's understanding of "indirect costs" – for example, ASIC's "Money Smart" website defines indirect costs to be "costs paid by your superfund to external providers that affects the value of your investment. Typically these are costs paid to investment managers."

A retail investor would not expect the fees and costs disclosures to capture asset level costs amounts. These costs will be incurred in respect of property investments irrespective of the nature

of the investment vehicle that holds the property, and it is not meaningful for retail investors to receive this information.

We are concerned that by requiring disclosure for some forms of property investments and not other investment categories, retail investors could be misled about the differences between the investment categories due to the artificially inflated costs associated with property when compared with other asset classes which are not required to disclose similar costs. This could then lead to poor investment allocations.

This would be contrary to the long-term interests of members and does not appear to accord with the objectives of RG97 which is to create meaningful disclosures for retail investors to assist with their investment decisions.

Recommended policy framework

To be effective and assist retail investors with their decision making, the fees and cost disclosures should be asset neutral and investment method neutral. This will ensure there is transparency applied fairly across all investment categories.

Importantly, the disclosures should be focused on the costs of investing via a superfund or MIS, rather than asset level costs. This will ensure a retail investor is better informed on whether investing in a particular product represents value for money. The current requirement to disclose costs that are incurred irrespective of whether a retail investor, a superfund or a MIS holds the investment does not achieve this aim.

To ensure comparability is achieved, it is critical that the regulatory framework (which encompasses legislation, regulations, ASIC regulatory guides and FAQs) is clear on the policy intent of the disclosures and sets out guiding principles to ensure the rules are interpreted consistently across funds. These guiding principles should balance certainty and flexibility to ensure the disclosure requirements do not impede growth and innovation in the funds management industry.

Applying policy framework to asset level costs under RG97

Superfunds and MIS can invest in property directly or indirectly. Indirect investment can include investing via a listed REIT, an unlisted property fund, a private equity fund or many other alternate investment structures. It is also common to hold each property investment in a wholly owned subsidiary or through joint venture special purpose vehicles.

This is no different to infrastructure, agriculture or any other type of investment which can also be held through different ownership structures.

Regardless of how the investment is held, there will be certain asset level costs which are essential to delivering returns from the property asset. These same costs would apply if the retail investor held the investment in the property directly.

Applying the above policy framework would mean that asset level costs associated with property, infrastructure or any other form of investment would **not** need to be disclosed as they relate to the asset, and not the investment structure.

In the property context, this will cover costs such as land tax, council rates, electricity, cleaning costs, and property management costs which are necessary to managing the asset irrespective of the holder and in many instances, cannot be influenced by the owner or manager of the property as these are set by government or statutory authorities.

Industry maintains its support towards greater transparency and is not disputing the need to disclose costs associated with the management of investments. Asset level costs, however, should not be confused with investment fees and costs.

Current disclosure of stamp duty is not meaningful information for retail investors

The above discussion regarding the interpretation of property as 'the end investment' also impacts how stamp duty costs are required to be reported under RG97. Industry is concerned that the distortion to cost calculations from stamp duty reporting requirements places property on an uneven playing field to other asset classes and is not meaningful for investors. This is because:

- stamp duty is a once only capital cost that is already accounted for in the unit price. Funds also typically disclose a buy-sell spread which is calculated taking into account acquisition costs (including stamp duty) and the frequency of acquisitions. As a result, the cost of stamp duty is already disclosed to investors and any further disclosure around specific stamp duty costs would be double counting.
- stamp duty is different to other transaction costs (eg legal fees), as it is a tax imposed by government and the owner of the asset has no ability to influence the amount of these costs.

The requirement to disclose stamp duty costs is impacting investment strategies – it is effectively encouraging Australian superfunds and MIS to invest in offshore property, rather than Australian property, as many offshore markets do not impose stamp duty. This would have significantly adverse impacts for future investment in the offices, industrial precincts, shopping centres and housing assets that Australia needs to underpin its growth and productivity.

Given the above, disclosing stamp duty incurred in year one would not be an accurate representation of the costs incurred by the investor. Therefore, the better practice should be that stamp duty should be excluded from RG97.

Next steps

Thank you for the opportunity to provide further information on this critical issue. We are keen to work with you and ASIC to develop a pathway that will provide meaningful disclosure to retail investors without inadvertently discouraging superfunds and MIS from investing in property which would jeopardise investor returns and the liveability of our cities.

Please do not hesitate to contact Belinda Ngo on 02 9033 1929 to discuss further. We look forward to engaging with you through the review process.

Yours sincerely



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