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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Corporations Amendment Regulations 2003-04 (Batches 6, 7 and 8)

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 3 March 2004

Members: Senator Chapman *(Chairman)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy, Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Brandis, Chapman, Conroy, Murray and Wong

Terms of reference for the inquiry:

To inquire into and report on:

Corporations Amendment Regulations 2003-04 (Batches 6, 7 and 8)

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CASS, Ms Debra Elaine, Chairperson, FSR and Compliance Committee, Australian Financial Markets Association **82**

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DRUMMER, Mr Chris, Manager, Government Relations and Policy, MLC Ltd; Investment and Financial Services Association Ltd **48**

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FERGUSON, Ms Carole, Senior Legal Counsel, Colonial First State Investments; Investment and Financial Services Association Ltd **48**

FRENCH, Mr Philip, Senior Policy Manager, Regulatory Affairs, Investment and Financial Services Association Ltd **48**

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KIMBER, Ms Sarah, Member, Insurance Council of Australia; and Manager, Compliance Risk Management and Corporate Affairs, American Home Assurance Company **69**

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Committee met at 3.39 p.m.

BAILEY, Mr Kevin Christopher, Executive Chairman, The Money Managers Ltd

CHAIRMAN—Today the committee is conducting a public hearing for its inquiry into the following package of regulations: Corporations Amendment Regulations 2003, batch 6; Draft Regulations, Corporations Amendment Regulations 2003-04, batch 7; and Draft Regulations, Corporations Amendment Regulations 2004, batch 8. Today the focus of the hearing will be on the regulations contained in batch 8. Before we commence taking evidence, I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament, its members and others necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. I also state that, unless the committee should decide otherwise, this is a public hearing and as such all members of the public are welcome to attend.

I welcome Mr Kevin Bailey. The committee prefers that all evidence be given in public but should you at any stage wish to give any of your evidence or answers to questions in private you may request that of the committee and we will consider your request. Today we have a number of witnesses. We do have a very tight time frame, and I advise witnesses and members of the committee that I will be sticking very much to the time frames allocated. I ask witnesses to make their opening remarks as concise as possible. Mr Bailey, I invite you to make an opening statement, at the conclusion of which we will ask questions.

Mr Bailey—Thank you for the opportunity to offer my views on the proposed regulations to require comprehensive and consistent disclosure of fees in dollar terms by all relevant parties under the Financial Services Reform Act. I am a certified financial planner and the principal of The Money Managers Ltd, which is the holder of a financial services licence. I have operated as a financial planner for over 17 years and have served on numerous industry committees and bodies during that time.

It is gratifying to see regulations reflecting the requirement to disclose in dollar terms—unless it is not possible to do so for a compelling reason, as determined by ASIC—being recommended, rather than the weaker disclosure which requires dollar disclosure only where it is reasonably practical to do so. Those that choose to disclose in dollar terms today find themselves at a commercial disadvantage to those that determine for themselves that it is too difficult to do so. This uneven playing field, which works in favour of the operator who discloses least, has the effect of reducing disclosure to the lowest denominator. I believe this is in large part why so few advisers elect to operate on a fee-for-service model, which is usually disclosed in dollar terms rather than on a commission based model. The two key changes introduced by the new regulations enhance consumer protection and pave the way for a more competitive and transparent investment environment. The new requirements no longer enable the licensee to determine those circumstances in which they should not be required to disclose in dollar terms by vesting those powers with ASIC.

The second welcome amendment changes the requirement for exemption from the need to disclose in dollar terms from situations in which it is merely not reasonably practical to those where it is genuinely not possible. I have spoken in several countries around the world over the last year or so, and many regulators and financial planners have applauded the comprehensive way the FSR Act is moving in the right direction in this country to empower consumers and encourage an efficient and fair system of securities markets. The eyes of the world are upon us and our reputation as a leader in the financial service profession is at stake. There are many entrenched interests that have a lot to lose from full disclosure and who will fight tooth and nail to maintain the status quo. They will argue that full disclosure will increase costs, but I believe that open competition will reduce costs and margins. They will argue that there is not enough time to change their systems by 1 July 2004 and, therefore, will look to delay implementation. I say that full FSR implementation has already been delayed for two years, and they should have been disclosing their costs and charges already as a matter of good practice. There are prominent organisations that will not surrender their favourite positions without a fight, and they have powerful advocates that have conditioned us to accept the status quo far too often.

The bewildering array of jargon, complexity and fine print that many in the industry propagate does little to assist investors in their understanding of the cost of assessing financial markets, and this must change. The imperative for this is highlighted by the disturbing results of the ANZ survey into national financial literacy conducted in May 2003. The survey provides a range of insights into the ability of Australians to make informed judgments and effective decisions about money. Amongst these, the survey identified that only 60 per cent of people within managed funds and 44 per cent of people with superannuation had a good understanding of the fees and charges associated with their investments.

The key objectives of the Financial Services Reform Act are to promote confident and informed decision making by consumers of financial products and services, fairness, honesty and professionalism amongst financial service providers, and orderly and transparent markets for financial products. In order for these objectives not to become platitudes, consumers need clear, accessible and transparent fee disclosure in an easily comparable form in statements of advice, in product disclosure statements and in periodic statements. This can only be achieved by categorising costs relating to advice, administration and fund management in dollar terms and giving a total cost in dollar terms. This should relate to all funds, including industry funds that often pretend their only cost is $1 per week. It should apply to self-managed super funds with their accountancy compliance costs as well as investment costs. It is the only way to give a true comparison of different services and the costs of those services.

Clear, comprehensive and transparent disclosure will empower consumers to make informed and rational decisions, drive down costs and force greedy and manipulative operators out of business. By raising the bar, you will drag this industry above the lowest common denominator and ensure a truly level playing field at a higher professional standard. This is the essence of sound policy making. I am confident to say that it is not only possible to disclose fees in dollar terms to consumers, but it is also simple and inexpensive to do so. Organisations characterised by their honesty and ethics have been doing it for years. Other organisations have deliberately employed actuaries to develop products and services that are designed to hide fees and charges, and they should be penalised. I cannot imagine many genuine circumstances where ASIC would determine that there is a compelling reason to exempt an organisation from providing a reasonable estimate of fees in dollar terms.

More to the point, I would anticipate that this is exactly why the regulations have been drafted in their current form, and I wholeheartedly support the provisions. In a low-inflation, low-return investment environment, cost minimisation is critical. It is absolutely imperative that investors understand the real cost of obtaining professional advice and of investment management. A statement that is misleading by omission is still misleading. If an investor is not fully aware of the cost of the service or the benefits that an advisor might receive by making a recommendation, then they cannot be expected to make an informed decision about whether the advice is appropriate.

It is an intolerable state of affairs that businesses that aim to disclose fully and in detail all initial and ongoing fees are being forced to operate at a commercial disadvantage. Any policy that supports omissions and that encourages vague and opaque explanations on fees by less scrupulous operators is bad policy. These regulations are vital to improving good practice. Thank you, Senator.

CHAIRMAN—Thank you, Mr Bailey. You referred to products on the one hand that are very transparent in terms of disclosure and, to paraphrase what you said, you also said there were some product providers who had actuaries design products to hide fees and charges in their products. Are you willing to identify some examples of both, of what you see as the good and the bad?

Mr Bailey—Certainly, on both sides of the equation. If we look at a lot of the life insurance companies, particularly those that were designing regular premium superannuation, they had very complex structures which could only be explained away by trying to hide the very high commissions that were being paid. Another example of that is where you have products that are so-called no entry fee products, which still pay a very high commission to the advisor recommending them, and therefore the ongoing charges often are much higher than if they had paid entry fees up front. So they should be called deferred entry fees rather than no entry fees. These are the sorts of products that have designed. There are many other products, particularly unit trust based products, that are very clear in their operation and explain exactly what their fees and charges are. An example of this would be Vanguard, which is a funds manager that has a passive index approach and educational material which explains what fees and charges are and how

The giving of advice is functionally separate to product. One of the things that I am concerned about is that we regulate advice not just product, because many financial planners that are truly doing their job have a fiduciary responsibility to explain costs and charges. My career has been spent trying to unravel many of these types of products and find all the loopholes and the different comparisons which are often impossible. I applaud the industry superannuation funds which have recently started to disclose, but for many years they gave the impression that the $1 a week charge was the only charge. There is, of course, a cost of funds management; they have institutional funds management, which only costs 0.4 or 0.5 per cent. In fact, the cheapest funds around are the industry superannuation funds and it would be in their interest to have a level playing field, but even they, I believe, have misled a lot of their members on the full costs and charges. I have noticed in recent times that they have started to come to the party. I think it is because these regulations are really bringing this forward and consumers are looking for that sort of disclosure, which I think very worth while.

CHAIRMAN—So you support the regulations as drafted?

Mr Bailey—I support the regulations with the amendments to have full dollar disclosure and to provide that where it is not possible to disclose that it needs to be determined by ASIC rather than have it determined by the individual operator. My experience in the industry is that when the individual operator determines whether it is feasible or not, inevitably they determine it is too hard to do, so therefore they just keep giving a convoluted answer as to what the fees and charges are. From a commercial point of view, I find that many of my peers whom I have encouraged to operate on a fee-for-service basis inevitably find they are at a disadvantage because people do not go to do work with them because they do not want to pay their hourly fees—they think they can go down the road and get it for nothing. That tells me that down the road they are not fully disclosing. Nearly every week in my career I have had to explain to people what the alternative costs and charges are, because people cannot work out what they are and they naively assume that they are getting something for nothing.

CHAIRMAN—What is your response to organisations like CUSCAL, the Bankers Association and the Association of Permanent Building Societies who have raised what they regard as the difficulty of disclosing fees and charges and things like termination values in simple deposit products?

Mr Bailey—I believe that they have been inflicted with the malaise and the disease of getting away with it for too long. They are frightened to show exactly what the costs and charges are because, as the experience in the UK and in this country showed, when people started to know that the first two or three years of a regular premium superannuation fund were going as commission to the salesmen those commissions disappeared. I have been disclosing fees and charges in dollar terms, breaking it down into the three components of investment—advice, administration and funds management—very simply and very easily. If it is just a matter of changing their letterhead or if they say it is difficult, and I cannot foresee why it is so difficult unless they have employed actuaries or spin meisters to design their systems to make them difficult to disclose in the first place, then let them pay a few dollars to get back on the level playing field. So I am totally opposed to the fact that they should be given any leeway to continue in their practices which have not been in the consumers' interest to date.

CHAIRMAN—Any questions, Senator Conroy?

Senator CONROY—Thanks very much, Mr Bailey, for your evidence. You indicated that some companies deliberately design their products to avoid disclosing. Do you think there will be any compelling grounds that ASIC will have to say no to, or is it in the nature of the way the products have been designed? Are there any products where you think it would be impossible to disclose?

Mr Bailey—There are no products that I believe would be impossible if there was a genuine desire to design the product to show what the cost of the business is. Where it might be difficult is because for 10, 20, 30 or 40 years they have been designing products and have employed actuaries and others to really hide their fees and charges, and it has become so common that they feel that is the normal way to do things. For whole of life policies, for endowment policies, there were complicated formulas. I remember that back in the 1980s it was absolutely diabolical. We

have been improving all the way along. I have travelled to other countries and spoken to other jurisdictions and they are looking at these same sorts of issues right around the world.

Australia is moving along the line, but these people are fighting a rearguard action, continually trying to slow the process down. I have even heard some operators lobbying local members about the fact that it will destroy small business if they have to disclose what they are charging. The most preposterous self-serving argument I have ever heard is that, if people knew what they were paying you, they would be devastated and would not use your services. It is about time that they had to disclose them. It is not just the advisers' fault; it is the fault of the funds managers and the institutions that have designed products specifically to make them easy to sell. One of the very frightening developments of the last year or so—I am not talking about the 1980s or the 1990s; I am talking about the last year or two—is where wrap accounts have, in the last five years, been the major administration platform for investors to access funds managers at a wholesale rate. The wrap accounts wrap up all the administration and they give you access to funds managers, but all the fees and charges are very blatant and they are there for everyone to see in the working cash account.

Colonial established a wrap account where it was all rolled up again—rebundled so that all the charges are below the line—and they took in over $2 billion or so in the last year. I am not sure of the exact figures, but I am sure we could look at those figures. When Colonial developed that product, the money poured in because people did not have to disclose what all their costs and charges were once again. So it was a huge backward step. Immediately all the other providers of wrap accounts set up what they called baby wraps and put it all below the line again. Shelf space is made available on wrap accounts, which are platforms that have a menu. The platform providers hit on the fund managers and they charge them shelf space to be on their platform. Once again it is a backward step, where suddenly the consumer does not know the cost of the administration, the cost of funds management or the cost of advice because the cost of funds management is now being divvied up, with some for the platform provider and some for the adviser.

This is why I believe in the dollar disclosure of the three aspects of investment management—the funds management cost, the institutional wholesale cost and whether it is an industry fund, a wrap account or an ordinary retail product. The cost of administration should be disclosed in dollar terms as well as the cost of advice, if people choose to receive advice. People can then compare one with the other if they choose to have no advice or no administration, or if they choose to have a menu where they can choose from 300 different choices. Choice is getting a bit out of hand and there is a cost to that. People can use Occam's razor, which is a philosophy where the simplest is usually the best and most appropriate outcome, and they can pay less, but then they should not complain that they are paying a lot more for a service that has got all the bells and whistles because they can see that there are different costs.

What you will find is that there will be a much more functional approach to advice, to funds management and to administration. I have seen some backsliding over the last two to three years, and it is of grave concern because those people who are genuinely disclosing in dollar terms have a distinct disadvantage. When someone has $100,000 to invest, for example, and the costs are $700 for advice, $700 for funds management and $700 for administration, with a total of $2,100, the investor takes fright, takes flight and races off down the road and places the money somewhere else where the cost could be double or triple that but not disclosed in dollars and

cents. So it is an unlevel playing field. It does make people say: 'Look, I give up. I'm not going to disclose, because all my competitors aren't.' We will always find that there will be a reversion to the lowest common denominator in this situation.

Senator CONROY—From what you have just described, from the example you just used, you would therefore see it as absolutely vital that we have this single bottom-line figure in dollars, so that comparisons can be made.

Mr Bailey—There is no reason whatsoever to have it in dollars and cents, but I actually would go further and say that it should not be the single bottom line only, but we should have those other three components so that people can compare apples with apples and they can make an informed decision. An argument has been put forth. I have been involved in industry bodies and argued these issues and in our professional association—the Financial Planning Association—we have rules of professional conduct and a code of ethics. There are arguments saying that the ongoing costs cannot be disclosed in dollar terms because you do not know what the fund is going to be worth in a year's time. In that case, you can very easily give an example and say: 'If it was $100,000, then two per cent of $100,000 is $2,000. If it goes to $110,000, then it is $2,200. Do you understand?' Instead of having this rubbish of saying, 'Oh, it's too hard, you don't know what it is going to be,' people need to have it explained in that way, very simply, and so that it is very easy to compare.

So my answer to your question is that a single bottom line figure for costs and charges should be on every quarterly statement so that people know what they are paying for advice in dollar terms every quarter. They know what they are paying for funds management and they know what they are paying for administration, and they can judge whether they are getting value for money for each of those segments.

Senator WONG—Would you say that the prime regulations do not go far enough in that they do not require those three aspects to be separately iterated?

Mr Bailey—That is correct. Even the current amendments, I believe, are saying that they should be disclosed in dollar terms, but they do not define what the aspects of funds management advice and administration are. People do not understand that, and quite often I think that comes from the fact that often the regulators are really trying to regulate product, rather than regulating advice, which is functionally very separate to product. The way that my business operates, we are looking at advice, and I think it is very important that advice is seen as separate and as being much broader than just, for example, receiving a commission on investing in one product.

One of the things that I see happening a lot these days is that often advisers may go to the extent of disclosing their commission, but let us say the commission is one-third of the cost, all they disclose is one-third of the cost; they do not disclose what the underlying fund managers at an institutional level are receiving. So they are not comparing apples with apples. We might disclose all of the costs in those three areas, which I believe as an adviser you must do because costs are the major impediment to return over a 10-, 15- or 20-year period of an investment; cost will have a huge effect in this low-inflation, low-return environment, and it is our responsibility to really analyse all these costs. We analyse them and explain them, but the competitor has just disclosed what their own costs are, and they leave out, by admission, what the fund managers are

receiving or the administration is receiving, and so people then say, 'Oh, you are only charging this much compared to this one that has got these three costs in there.' The others are just hidden and so, therefore, the consumer cannot make a good comparison.

There are some services, for example, like Vanguard, which is an index fund, where there is no advice, there is very little administration because there is one fund manager, one institution, whereas others may have many fund managers that they put together, and so you get a better quality of choice and, therefore, there are extra costs involved, and people then need to make a decision about whether they want to pay for those choices.

Senator WONG—These regulations apply across a great range of products: would you say all of them are products in relation to which those three categories would be relevant?

Mr Bailey—Yes, they would be relevant. Every single product that is involved in investment they do not apply to mortgage products, unfortunately; they do not apply to real estate advice, unfortunately—a state requirement not a federal requirement—and yet there are lots of seminar providers giving real estate advice—

Senator WONG—Let us not go there, Mr Bailey.

Mr Bailey—That is a different subject, but every one of these types of products that this would relate to has some administrative cost in, even if it is self-managed fund or an industry super fund, and a product does have funds management cost. No-one does it for free, they are not the St Vincent De Paul Society, and it does potentially require advice, and if there is no advice then people see that there is no advice and they are not paying for it.

Senator CONROY—Mr Bailey, you are well known to me because I listen to you regularly on a Saturday morning in Melbourne, but I am the only one from Victoria, so I was just wondering if you could just outline your background. You would be a small businessman; you have possibly grown a bit larger than the true definition of small, but you certainly started as a small business.

Mr Bailey—In the industry, we call it boutique.

Senator CONROY—Sorry.

Senator WONG—Small but important.

Mr Bailey—We do not like being small. But, yes, I have a practice that employs 26 staff and has approximately $300 million under advice for individual investors. I started the business just under eight years ago after working for 10 years under a national licensee. I have been very involved in many, many industry bodies. I have been involved in drafting a code of ethics and rules of professional conduct for the professional body. I have been involved in education committees, practitioner advisory committees and the board of the Financial Planning Association for a number of years. I have also written a book on investment and I write a regular column for the *Herald Sun* newspaper. I do a number of programs for ABC radio and I write for a number of industry journals.

I am well aware that there are many people within the financial services industry that are fighting very hard for standards but are having a tough time of it because of the weight of vested interest in the status quo. Many people call themselves fee based advisors, but the majority of their revenue comes from trailing commissions, which are not disclosed and are very much hidden. Most people would not know what they have paid in trailing commissions to their adviser over the last 12 months, but they know what their telephone bill is and they know what their electricity bill is, because they are delivered in dollars-and-cents terms.

CHAIRMAN—You advise on collective investments, in essence?

Mr Bailey—Yes, I do.

CHAIRMAN—Not on direct investments?

Mr Bailey—I advise on the full range. We have an unrestricted securities licence.

CHAIRMAN—So you advise on direct investment in shares?

Mr Bailey—Yes. And there are brokerage costs and collective investments. Superannuation falls into that category. So it is really looking at the full gamut of ways that people can invest. There are many ways and means of charging—kickbacks, soft dollar arrangements and all sorts of things; the sorts of things which ultimately the public simply does not want to have to be involved in, but it is very difficult while things are not disclosed in dollars and cents.

Senator MURRAY—I want to talk to you about the concepts of prospective and retrospective. I will give you an example in tax. Many people, including me, have had the experience of being asked to estimate their tax. The tax office gives you a provisional tax return, and you pay it in advance. I have never known those to be accurate.

Mr Bailey—That is correct.

Senator MURRAY—After the event, at the end of the year, when you put in your actual return, invariably there is a great difference. It seems to me that one of the cases being made for those who have difficulty in exposing the dollar cost up-front is the difficulty of estimating that, particularly where you have flexible products which are relative to market returns and so on. I know that that is the best time at which you should know what your up-front charges are, so I do not quarrel with that principle. But, at the end of a year, a provider of a service should know what fees and charges they have taken from a customer on all three of the elements that you outlined. How difficult would it be to make those who do not provide a quote of their dollar fee up-front—as allowed by ASIC, as you suggest, rather than being self-regulated—tell the customer what they have taken out from them during the year?

Mr Bailey—They can tell the investor what they receive in income. In order to calculate that, the institutions have to know that. In order to pay trailing commissions, they have to know that this information is readily available and known. It is a simple case of a little extra ink to put an extra line—or two or three—on the statement that they send out to their investors every three months. The annual statement at the end of the year could break down what those charges are. If

they do not know what they are, then they need to move off the 1960s computers and move into the modern era where they can do it on an Excel spreadsheet.

Senator MURRAY—Is not the weakness of the system we have been proposing—and it is established in law; we are just arguing about the detail—that we are concentrating entirely on estimations on the prospect of advice as opposed to recounting the actuality of what has happened? I have the feeling you should have both. If one end is a bit shaky in some areas where people do not, or cannot, provide an accurate dollar fee estimation, you certainly need the other end. Even where you do get provided with a dollar fee estimation, you should have it validated at the other end because what is to prevent someone telling you what their costs are and you believing them, and them underestimating either deliberately or inadvertently?

Mr Bailey—In the many years I have operated as an adviser looking at products, services, collective investment schemes and direct investments, I have had to deal with this on a day-to-day basis. It is very easy to understand that if an investor has a lump sum of money that markets can go up or down. But, by just doing the simple arithmetic, we can give them an indication that if the portfolio stays exactly as it is it will be this amount, this amount and this amount. It is patently obvious to me after many years that, although I would expect the average consumer should be able to do that for themselves, they cannot and they do not. Doing the simple arithmetic for them gives them a very good understanding, because it is so critical to the impact on their bottom line return over time.

In relation to what the portfolio is going to perform at next year, if it goes up by 50 per cent then of course that fee figure will be 50 per cent higher, but let us assume that markets go up on average by 10 per cent. Even if they went down by 10 per cent it is a simple explanation to show in a statement of advice what you anticipate that to be according to these rules. They write out what the rules are. You then just apply the mathematics to those rules and you give them a very good understanding of what they are up for. Then you have the job of explaining what value you are adding for doing that work. If it is not good enough value then they do not pay. If it is good enough value they see that as worthwhile.

Senator MURRAY—You are talking about the prospective process again. I want to concentrate on the retrospective costs. Assume you as an adviser gave somebody some advice in, say, January and you said, 'This looks like the total fees and charges but within your investment portfolio there is a very flexible component because it is market related and we cannot be certain what commissions will result from that. However, at the end of this process, we will provide you with a statement telling you what we have actually taken from you.' What would be the best date if this were ever to be considered in regulatory or legislative terms? What would be the best date to require that reckoning to occur? Should it be at the choice of the client and the adviser, which might be related to the date the first advice was given, should it be related to the year end of a corporation or should it be related to a tax year end? Does there need to be a date by which a reckoning occurs?

Mr Bailey—Certainly it should be the taxation year. In our industry it all occurs at taxation year—30 June—to know what you have spent over the course of the year. People want to claim some fees and charges as legitimate taxation expenses and the 30 June statements come out by the end of September. Therefore, that is the date that would be the most appropriate and most sensible for what they have expended over the course of that year and to break down where that

money has been expended. As it stands, they get a statement but the fees and charges are below the line. They give you a statement after they have taken out the fees and charges. People do not know what they are unless they go back and study the prospectus, which very few people do.

Senator MURRAY—Would it be difficult—I cannot conceive it would be but I will ask you the question on the record—for the dollar value to be given retrospectively—in other words, to record what actually happened—and as a percentage of the invested amount?

Mr Bailey—It would not be difficult at all. It is the sort of thing that could be done with the flick of a switch today unless people are deliberately wanting to conceal it, I believe. It is something that we have been doing for many years and many people in the industry do, and they acknowledge that they are able to do that. But they are not going to do it when their competitors are not doing it. So we get back to the lowest common denominator situation.

CHAIR—Thank you very much for your appearance before the committee.

[4.15 p.m.]

CLARE, Mr Ross, Principal Researcher, Association of Superannuation Funds of Australia

PRAGNELL, Dr Brad, Principal Policy Adviser, Association of Superannuation Funds of Australia

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but should you at any stage wish to give any part of your evidence or answers to questions in private you may request that of the committee and we will consider such a request. We have before us your written submission. Are there any alterations you want to make to the written submission?

Dr Pragnell—No.

CHAIRMAN—I invite you to make a brief opening statement at the conclusion of which we will move to questions.

Dr Pragnell—Thank you. ASFA welcomes this opportunity to present on the Corporations Amendment Regulations and, in particular, issues related to the disclosure of fees, charges and expenses by superannuation funds. Firstly, the long tail of FSR reform has been most unfortunate. While the best outcomes for consumers are critical under this reform, we must be mindful of the impact of ongoing changes. Indeed, in the case of superannuation it is often the member who pays for additional compliance costs and disclosure requirements through higher administration fees.

Secondly, in respect of draft regulation No. 8, we had previously made a submission to Treasury which we have attached to our submission to this committee and we look forward to the committee considering it. It is our view that whether or not the test is reasonably practicable or not possible for a compelling reason for dollar based disclosures may actually be less important than how ASIC may interpret and enforce that requirement. We have provided some suggestions in terms of things that ASIC may consider in deliberations and determinations.

Thirdly, and probably for ASFA most importantly, is the provision of a single bottom line. ASFA supports meaningful fee disclosure at point of sale—in other words, disclosure that can be understood by consumers and that allows them to compare the relative costs of investing through a particular vehicle. Fees may not be the only basis on which consumers make a decision. However, when confronted with a choice of fund, consumers need to know up front what it would likely cost them.

What we are presenting today represents a draft working model for PDS statements based on our previous research. This model, which we have presented to the committee and made available to other interested stakeholders, still requires consumer testing but we feel represents a good effort in working towards a single bottom line which is necessary for superannuation fund members to make confident and informed decisions. That is it from me, unless Mr Clare has anything to add.

Mr Clare—Nothing from me at this stage.

Senator CONROY—I understand you have been involved in discussions with IFSA about trying to reach a common position on this issue. Where are those discussions at?

Dr Pragnell—The boards of ASFA and IFSA recently met to consider whether there might be a resolution of differences between the two organisations on the preferred approach to fee disclosure. ASFA have developed our own model, which we have presented to the committee. This is ASFA's preferred model and one which we consider is both technically possible and practicable. We would, however, welcome refinements to help ensure better disclosure. We hope that our further discussions with IFSA will be able to bring about an early conclusion to these discussions.

Senator CONROY—How long have there been discussions, not just at board level, and when did you start these discussions with IFSA?

Dr Pragnell—The board-level discussions were relatively recent—over the past couple of months. We do maintain a good working relationship with IFSA in terms of policy staff, and we do have some joint members as well. But the most recent round of discussions has been relatively recent.

Mr Clare—Disclosure has been an issue that has had quite a long history, and ASFA have gone through a number of iterations with consumer testing and other material. The stage we are at now has benefited in some ways from that earlier process.

Senator CONROY—I remember there was a regulation, which had the support of Senator Murray, that was disallowed on this very issue at least 12 months ago—maybe even 18 months ago. I presume you have had at least a conversation with him since then to try to resolve the issue.

Mr Clare—I think it is fair to say that there have been numerous conversations. We feel that we have made progress. We have benefited from the consumer testing and the views of other organisations. Achieving unanimity of views is not always easy. That is not restricted to the financial services sector and disclosure issues.

Dr Pragnell—Both organisations were involved in consultations with ASIC around the fee model as well. We did have a couple of meetings with IFSA in relation to that. They were not at the board level—they were more at the policy operative level—but we did have some meetings around that.

Senator CONROY—You mentioned that you have been doing consumer testing on this. Are you aware of whether IFSA have done any consumer testing?

Dr Pragnell—You may wish to ask the IFSA representatives that question.

Senator CONROY—Do you know if they have ever met a consumer!

Dr Pragnell—You may have to ask the IFSA representatives that question.

Senator CONROY—I might. In your view, why was more money put into bank accounts than into super funds last year, despite the mandatory super contribution rules?

Mr Clare—Bank accounts are used for a large variety of purposes. Their use for transactions is quite important. In times when economic and financial circumstances are uncertain, some people may feel more comfort there. In terms of long-term savings for retirement, superannuation remains the dominant form. After home ownership, a person's retirement savings in the form of superannuation are their next largest financial asset. That is most unlikely to change in the future.

There are a whole range of reasons that people put money into bank accounts. In times of uncertainty, it might be a place of comfort. Equally, it is quite clear that, over the longer term, investment returns are stronger in equities. For most individuals a managed investment in equities or, as is more common, a managed investment in a balanced portfolio is the sensible direction to go in. Certainly, you will get some fluctuations from quarter to quarter but I am not convinced that there is any evidence of a long-term trend away from funds that are tax advantaged in many circumstances and offer superior investment returns. We are seeing that turn up over the most recent 12 months in terms of the returns that superannuation funds and other managed funds are delivering.

Senator CONROY—Why in ASFA's view do consumers need a single bottom-line figure showing the fees and charges that they have paid?

Mr Clare—The attachment to our paper on the draft working model outlines some of the reasons we believe you need effective fee disclosure. They concern the rights of consumers, and consumer confidence issues. There needs to be informed choice. It is a very important factor impacting on the benefits that will finally be delivered to individuals for their retirement. And there is the effect on competition. We believe that those various objectives can be furthered in a variety of ways, but one technique which we see as useful in achieving those objectives is to provide a single bottom-line fee comparison for consumers.

Senator CONROY—Your submission states that you have done seven rounds of comprehension testing to determine consumer comprehension of different formats of fee disclosure. What has the testing shown?

Dr Pragnell—The testing has been quite clear that consumers prefer dollar based disclosure as opposed to percentages. I think that is one thing that has come through very clearly. Consumers can understand dollar based disclosure—they can make sense of it—and they struggle with even simple concepts of how percentage based fees are removed. So definitely people respond better to dollars than to fee based.

People prefer fee information to be located in a single location within the disclosure document as well. When the fee information is scattered throughout the document it is very difficult for people to get it a full sense of fees. As well, we found that providing, in relatively simplistic language, information about what the fee does and when the fee is removed is of assistance as well. So those are the kind of things that we found. We have found that people do want an illustration that does allow them to determine the impact of fees over the length of the

investment and likely account balances that will allow them to compare the impact of fees over the long term.

Senator CONROY—Could you just take the committee through how your single bottom-line fee model works?

Mr Clare—What we have tried to develop is a fee illustration which is relevant to the large majority of people with superannuation, which is the dominant form of managed investment for most Australians. We have tried to focus in on what we perceive to be—and what objectively are—the common cases. Our consumer testing has shown quite clearly that, when you try and make for an increasing level of sophistication—catering for all available options and circumstances—you end up with a maze for most individuals. It is hard for professionals to read. The consumer testing has shown that ordinary consumers—our members—do struggle. So it has been a refining down to what we feel is a simple and fairly singular sort of measure. We are talking about a fee illustration which covers a balanced fund investment, where around 70 per cent of the investment portfolio is in growth assets—equity and property and the like—and the other 30 per cent is in bonds and cash and debt-bearing instruments. That actually corresponds to what most people with superannuation have in their investment portfolio.

We also say that the fees for that sort of portfolio are fairly indicative for the fund as a whole. It is most unlikely that a fund will be expensive or cheap for the balanced fund option but vice versa for another option. If they are expensive for the balanced fund, they will be expensive for cash and they will be expensive for international shares. Equally, if they are relatively low cost for the balanced option it is almost certain they will be lower cost in the other options because there is relativity between them. We are using an example of an investment portfolio which we feel is relevant and gets away from the problem of people trying to compare the costs for cash and for a balanced portfolio within the one fund and confusing the investment decision because the returns are different. It also allows us to centralise on one assumed earnings rate that we think is indicative of what applies to a balanced fund investment over the longer term and not a short-term period.

Senator CONROY—Your modelling includes entry and exit fees. Can you advise the committee why that is important?

Mr Clare—We included entry and exit fees because they can be substantial and have an impact on individuals. We most likely would not include them for modelling purposes—it would not be that relevant—a $10 or $20 administration fee but, when you are talking about two, three or four per cent and sometimes even higher percentages on entry or exit, it can have a significant impact on a person's fund balance, particularly over shorter periods of years.

Senator CONROY—I am sure you have heard that some in the industry would say that disclosure of entry and exit fees should not be included in the model as sometimes these fees may be waived. Should consumers be entitled to know what these fees are potentially?

Mr Clare—Certainly some arguments have arisen in that area. For personal retail products it is quite common for two or three per cent entry fees, or higher trails in some circumstances, to be charged. That is the reality for many people. The previous witness was a little unusual in running a financial advice practice solely on the basis of fee for service to the client. What level

you should put in is a matter for debate, and that has been quite a healthy debate in the industry—whether it should be the maximum or whether it should be what is common. We also take into account the fact that people who do not exercise options may well end up paying the maximum rate. People can negotiate with a financial adviser but if they do not, or if they go to a financial institution direct, that rebating will not occur. We are also very supportive of disclosure material and making it clear to potential members or customers that it is possible to negotiate rebates. A number of other jurisdictions, including the United States, require funds to make fee disclosure in dollar terms which include the maximum.

Senator CONROY—Is the maximum the one you think it should be?

Mr Clare—Yes. The United States Securities and Exchange Commission has mandated that approach. It has not, I think, brought their managed funds industry to a stage where they cannot operate. In that jurisdiction there are many more funds which do not charge entry fees, but a significant proportion of them in the industry do. Consumers in the United States have been able to cope with that information. It is a matter of footnotes and understanding, but we think that the entry and exit fees can be very significant and we regard disclosure which does not take them into account, or requires individuals to do a couple of calculations and put it all together, as not helpful. The ASFA web site has a fee calculator which assists people to do that. Subsequently, ASIC introduced a calculator which does much the same. But disclosure material is what people are required to get, and we see having these fee illustrations as being helpful there.

Senator CONROY—Can the adviser remuneration be disclosed?

Mr Clare—The adviser remuneration technically comes out of the fees that are collected by the trustees, in most instances, and then passed on. In the disclosure arrangements there is a requirement for those adviser fees to be disclosed. The question in relation to this fee illustration—whether you have the adviser fee in brackets—is a matter that I think needs to be considered. In the model we have put forward to you we just have the total fees, but that might be one of those—

Senator CONROY—So you do not break it out separately. Do you say, 'Because it is disclosed somewhere else, we do not have to include it'?

Mr Clare—There are arguments both ways around it. In what we have put forward, which is a draft working model and presented as such, we have not done that break-up; but it is an issue that may deserve further consideration.

Senator CONROY—Mr Pragnell made the point that consumers want dollar disclosure but also want it consolidated into one figure. They want it all in one place, I think you said, not scattered across three different pieces of paper or across different pages—page 77 plus page 92 plus 174. They want it all tabulated in one point so that they can easily look at it.

Dr Pragnell—Correct.

Senator CONROY—Some in the industry would say that a single bottom-line fee model may be misleading because it does not show the actual fees paid by the consumer. Some of Senator Murray's conversation with the previous witness was along those lines. Do you think that that

argument holds up—that the indicative sorts of figures that your model provides are way too misleading?

Mr Clare—I do not feel that they are way too misleading in terms of the variation from year to year and fees payable due to fluctuations in investment performance, for instance. In most instances you will not get much variation in the fees. In the superannuation field, for a balanced portfolio, the weightings of those elements where the fees are not investment performance related are such that the historical figures will generally be reasonably accurate.

There may be a small minority of cases where the historical pattern, and that is what we are really working on with our fee illustration, may not be truly indicative of what may happen. But, in those circumstances, when you have a much higher return you may be paying a higher fee but you have an offset. Generally those performance fees are designed so that the account holder gets the greatest part of the benefit of the higher than average returns. Equally, some of those performance arrangements may lead to a lower fee when investment performance is below average. So again there is a bit of a sharing of the risk. However, for the great bulk of cases, we feel our fee illustration is very close to the mark and accordingly of assistance to consumers.

Dr Pragnell—Also, importantly, the fee illustration allows true comparability on an apples for apples basis. There is a bit of a Gordian knot that has to be cut and certain decisions have to be made to allow for that interfund understanding so that people can compare two products beside each other even though the number may not be what they end up paying. It will allow them to compare whether a fund is cheap, modestly priced or expensive and to factor that in to their overall decision making of whether that is a suitable product for them.

Mr Clare—We emphasise that individuals need to take into account a variety of factors but that price is not unimportant. To that extent, we see it as desirable to get a clear, potentially helpful piece of pricing information to consumers. It is certainly not the only factor that we would say individuals should take into account, and that is why we have clear, concise and effective disclosure in other areas. This is our attempt at just one area.

Senator CONROY—When the Chant West research was released at the ASFA conference in November, your CEO said that ASFA had done the hard part and that all it needed now was the support of the regulator and the government. Have you got that yet?

Dr Pragnell—You may have to ask them that question.

Senator CONROY—I am asking you if you think you have got it. Philippa has said 'What we need now is the support of the regulator and the government.' In your view, has ASFA got the support of the regulator and government on this issue yet?

Mr Clare—I think the matter is still to be resolved.

Senator CONROY—A work in progress.

Mr Clare—Yes. I think there is recognition from the regulator that the fee table is not the sole and final answer to the matter of fee disclosure. Again, it might be a question for government members and ministers, but there may be recognition that the fee table is a very useful step

forward but that there may be other things required. We are encouraged by the consultations that the government and the regulators have been undertaking looking for the further steps and the industry consensus to move forward.

Senator CONROY—When the ASIC fee table came out again your CEO said:

... our consumer testing showed that it couldn't be understood by ordinary fund members ... It is not good enough to get the experts together to design a fee disclosure model, unless you put in place the reality checks to ensure ordinary people can understand it.

Did ASIC do any consumer testing?

Dr Pragnell—Again, you may have to ask ASIC that question. My understanding is that they did not test the fee model, and we did recommend that they do that throughout the consultation process. When ASIC issued the final fee model document they indicated there was room for other tools to assist consumers in terms of understanding fees, including comparability tools, which we feel is what the single bottom line is about. They did see it as part of an ongoing process; they did not see the fee model as the end of the process.

Senator CONROY—Last week, and you might have already seen this, Mr Costello, who has become an instant expert on superannuation recently, said:

I call on the superannuation industry to consider its level of fees. I think that this is one of the things that is concerning people, the level of fees that superannuation funds charge.

In your view, will the superannuation industry voluntarily decide to reduce its fees, or is government regulation required?

Dr Pragnell—I think we would hope that true meaningful disclosure to consumers to allow them to make decisions that include price will put downward pressure on fees. That is the only way if people do not understand—

Senator CONROY—But you have to get proper disclosure, genuine disclosure.

Dr Pragnell—Yes; true, genuine, meaningful disclosure.

Senator CONROY—I always call it 'total cost to customer', that is what I talk about, so I am always a sceptic when you have got the ASIC fee model, because it does not actually tell the consumer what it is actually costing them. So I am a bit of a fanatic, as many people in the room would know, on that issue, because I think that, at the end of the day, that is the only way.

Mr Clare—Customers at the wholesale level actually do a lot to keep fees down. You talk to administrators, investment managers and the like, who have done a—

Senator CONROY—That was my last question, so I will pass over to Senator Murray, but thank you.

Senator MURRAY—You were in the room when I questioned the previous witness. I support fee disclosure in dollars as well as percentages. I do not think it is an either/or situation, but if you want to rank them, I do not disagree with your ranking as the dollar being more important. But I also believe that people need to be able to compare what the estimation has been with what reality turns out to be. The regulation requiring disclosure will come into play on 1 July 2004. Do you see any difficulty were the government to require all products that are covered in this way to return to the customer an actual fee and charges disclosure for the year ending 30 June 2005, so it will be thereafter? And I am aware, of course, that many insurance products already do that.

Dr Pragnell—I think that in consultation with some of our members, the preference is to have at least the 18-month lead time, because the explanation that has been given to me is that they need at least six months to make the systems changes so that they can then collect the data for the entire financial year, and then they can report at the end of that financial year. So the window of opportunity is very tight, I think, now that we are into March of 2004 in terms of being able to give that time frame.

Senator MURRAY—What will be a commencement date? I appreciate this is off the cuff.

Dr Pragnell—Off the cuff, I would say for industry at least, the parts of industry that I have been able to consult with in a relatively short period of time, that 1 July 2005 would probably give people the necessary time to make the systems changes, to be able to collect the data for the entire financial year and then to be able to report on a meaningful and accurate basis.

Senator MURRAY—So let me understand your answer. Are you saying the collection would be for the financial year 2005-06?

Dr Pragnell—Yes, it would be for 2005-06, and then you would report for 2005-06. You need 12 months to collect the data.

Senator MURRAY—I am still not with you. Would you be able to change the systems so that, for somebody who has gone through the 12 months from 1 July 2004 to 30 June 2005, they would get a report on that year, or would that have to be the year in which the systems were set up and the reporting would actually be for the following financial year?

Dr Pragnell—Sorry. My understanding would be that the system changes need to be done first, so that you can collect the data for the 12 months, so that you can then report on it.

Senator MURRAY—Which means to me the financial year 2005-06.

Dr Pragnell—Yes, just to make the systems changes to be able to collect the data. Otherwise, if it is 1 July 2004, you would be able to do some reporting on a dollar basis, but some of it would have to be dollar based examples, or notional dollar basis, or other types of shorthand as opposed to actual dollar basis.

Senator MURRAY—Are you talking prospectively now or retrospectively?

Dr Pragnell—No, that is retrospectively.

Senator MURRAY—Why is there difficulty? Everything you get paid is in dollars; you never get paid in percentage.

Dr Pragnell—Yes, but certain charges and expenses are paid on a collective basis by a superannuation fund, for example, to a fund manager or a service provider, and it is not necessary apportioned back to individual members.

Senator WONG—Just to clarify, the collection of data and the deferral of reporting back till the 2005-06 financial year was in relation to what I think Senate Murray described as the retrospective fees?

Dr Pragnell—Retrospective information in terms of that. That does present considerable difficulties time wise, systems wise.

Senator CONROY—Sorry, I may have asked you this already.

CHAIRMAN—We are way behind time already.

Senator CONROY—That is fine, thank you for that, Chair, but I just have one more question.

CHAIRMAN—More questions here will be less questions later.

Senator WONG—You can argue, but it is going to take a longer time.

Senator CONROY—I do not mind having a second day of hearings, Senator Chapman, if that is how you are going to behave.

CHAIRMAN—No, you won't.

Senator CONROY—Hopefully we will not have to worry about that. You did consumer testing on the ASIC model?

Dr Pragnell—Yes, we did.

Mr Clare—The fee table.

Senator CONROY—What were your findings on that?

Dr Pragnell—The positive findings were that people appreciated the fees being located in a single location. They appreciated fees being presented in the table format, but they found confusing the two tables. There are two tables, one significant fees and the other one a breakdown of ongoing fees. People thought that they were separate, that they were just a continuous list of fees. They did not understand how table 1 interacted with table 2. They did not read the other additional information that sat underneath the second table. They found some of the definitions a little bit confusing. Those are the types of negative responses we got back. We have passed them on to ASIC, and I think there is work being undertaken on that.

Senator CONROY—Thank you.

CHAIRMAN—Thank you, Dr Pragnell and Mr Clare.

[4.47 p.m.]

CHANT, Mr Warren Roy, Director, Chant West Financial Services

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public, but should at any stage you wish to give part of your evidence or answers to questions in private, you may request that of the committee and we would consider such a request to move into camera. I ask you to make a brief opening statement, at the conclusion of which we will move to questions.

Mr Chant—Thank you, Senator. I will start by briefly explaining who Chant West is, and I have actually provided a document, because I will be referring to this. Chant West is an independent research based superannuation consultancy that specialises in providing outsourcing advice to employers and trustees. Over the past seven years we have gained considerable experience in providing this advice.

Our clients have included BHP, Boral, Coles Myer, IBM, Leighton, OneSteel, Orica, St George, Thiess, Westpac, WMC Resources and Extrata. The important point to note here is that all of these clients have been provided with bottom line fee comparisons employing the same methodology used in the research we conducted jointly with ASFA. The smallest superannuation fund amongst that group of clients was $200 million and the largest was just under $3 billion, meaning in essence we are in the business of providing advice on superannuation funds, and an important part of that is providing advice on fees and fee comparisons producing bottom line figures.

The research we conducted with ASFA differs from previous published research in that it sets out the fee structure and bottom line cost of each of the almost 50 funds on a comparable basis. Fees are presented in a format that is consistent with ASIC's fee disclosure model released in July 2003. In essence, the research road-tested ASIC's fee model to see if it produced fair comparisons that would aid consumers in choosing between funds. In our view, it does not, for three key reasons: firstly, it allows funds to choose whether they show fees on a gross or net basis—that is, gross of tax or net of tax; secondly, it does not specify an investment option to allow for a bottom line fee comparison; and, thirdly, it does not include contribution fees in ongoing costs. I will address each of these three key issues separately.

On the growth versus net issue, very simply, most life companies quote their fees on a net basis. What we mean by that is: if the fee charged to the consumer was $100, they would show it as $85. If you were comparing a life company product with a non-life company product, the life company would show the fee as $85 and the non-life company would show it as $100. In fact, they are the same fees—they are just shown differently. We think it is a very simple thing to change the ASIC fee model to require all funds to show fees on a gross basis. We cannot think of any area in financial life where fees are quoted to anybody on a net of tax basis. I will show you an example in a moment where this is very misleading.

Secondly, we believe it is possible to actually specify an investment option that is common to most superannuation funds and most individuals. I will take you to the table on page 1, where we

have the Australian superannuation industry. It shows APRA's figures at June 2003. The size of the industry was $535 billion. If we take out small funds—DIY funds—and annuities, we are left with $401 billion. That is really the area of debate on fees. If you look at that $401 billion, you will see there that what we call master trust retail, so the retail market, represents about 34 per cent of that total.

So we are saying that 66 per cent of the market is in fact what we would refer to as wholesale. The important point to note about wholesale is that most of that wholesale market is invested in what we call multimanager investment options. By the term 'multimanager' we mean that, for these funds, typically the investment committee would sit down with an expert asset consultant and together they would choose the best managers in each of the various asset sectors. So, in a so-called balanced portfolio, you might have between 20 and 30 investment managers managing the money. By way of comparison, if you took a manager like the AMP, they might have a balanced fund called AMP Balanced. What that means is that AMP is the only party that manages the money. AMP also has a multimanager product, which they refer to as 'Future Directions'. Within that product, they might have 20 or so managers managing the money.

The next important point is that, if we look at the second table on page 2, we can see that, of that $534 billion, 72 per cent of it is invested in shares and equity. So what we are saying is that the average investor in Australia is invested in a well-diversified portfolio in terms of the spread across asset sectors and also the spread across managers. Most Australians are invested in a portfolio that has about 70 per cent of its assets invested in shares and property and most Australians have their superannuation invested in what we refer to as a multimanager type product. If that is the case, if you are trying to make bottom line comparisons, it seems perfectly reasonable to use in your comparison that investment option that closely follows the growth option I have just described.

I will take you to the last appendix, attachment B, on the back page. In February of this year the AMP produced a new disclosure document that complied with the ASIC fee disclosure model. The example I have here, called 'Case Study 1', is taken directly out of that disclosure document. The example is of a person called Cathy, who has $10,000 to invest—$2,000 is invested in the AMP Cash Plus fund and $8,000 is invested in the AMP Balanced Growth fund. If you look at the table, in the second column, headed 'Amount', you will see that the total ongoing fee for the year for Cathy is $181. In the column next to that, we have adjusted those figures to gross up the fees for tax. In other words, you will see at the top of the table that the administration fee is $155, and we are saying that is a net figure, and if you gross that up it becomes $182. If you look to the bottom of the table, you will see that in this example the AMP is saying that Cathy's annual ongoing costs are $181, and according to us they are $259.

One of the main areas of difference—and you will see the line under $77—is that we are saying that, instead of using AMP Cash Plus and AMP Balanced Growth, which are quite cheap, the multimanager growth option costs 77 base points or 0.77 per cent per annum. We think that difference of $181 versus $259 is a significant figure. AMP has complied with the ASIC table as it stands now—they have done what they have been asked to do—but we are saying that that is not the way that most Australians would view a cost calculation. The second table is about Cathy again. In this case Cathy is a member of an employer plan which is large enough to get a discount because of its size. You can see that according to the AMP's figures, the cost to Cathy is

$134, and we are saying that the cost is $204. We use this methodology day in, day out in our business and we find that it works.

There is another area of concern with ASIC's fee model. Remember that I said that about 66 per cent of the superannuation funds are in what we call the wholesale market. In the wholesale market it is extremely rare for a contribution fee or an adviser trail to be paid. So for 66 per cent of the market, when people get their statements there is no concept of a contribution fee and there is no concept of an adviser trail. It is just in that one-third of the market—the retail market—that you have contribution fees and an adviser trail. With contribution fees, in the way the ASIC table is at the moment, you do not have to include that in ongoing fees. We are saying that, in the retail market, we think that is misleading.

If you think about the figures for a moment, if somebody was making contributions of, say, $5,000 per annum and they were paying a contribution fee of, say, 4½ per cent, that is about $230 a year. If their average account balance for the year was $10,000, they would be paying 2.3 per cent per annum, which does not show up as an ongoing fee, and yet they are making contributions every year—by legislation, they are making a contribution of nine per cent of their salary. So, if that person's average account balance was $20,000 instead of $10,000, then the 2.3 per cent would be divided by two and you would get 1.2 per cent. So we are saying it is a very significant fee. In the retail market it is probably the most significant fee that members will pay, and, by not including it in ongoing fees, we think it is very misleading. Remember, we are saying that 66 per cent of the market does not have a contribution fee or does not have an adviser trail, so when those people will inevitably be asked to compare their fund with the retail market, using ASIC's tables people will not have a fair comparison to make and they could easily be misled. That is the thrust of the research that we carried out with ASFA, and we are waiting to see some changes to the ASIC tables.

Senator WONG—Your evidence about the 15 per cent is quite clear. Can you explain again how you arrive at the $77 as opposed to $26?

Mr Chant—In this example, the AMP is saying that Cathy will invest 20 per cent in AMP Cash Plus and see there the 0.1 per cent is the cost of that product. AMP Balanced Growth, the cost of that product is 0.3 per cent, so you can see how you get the $26. What we are saying is that when you look at the investment menu that an investor has to chose from in this particular product there is a product there called 'Future Directions Balanced' and that product costs 77 basis points. What we are saying is that is the product they should be using for comparative purposes because most Australians are invested in a product like that. Firstly, it is multimanager and, secondly, it has about 70 per cent of its assets invested in shares and property.

Senator WONG—Yes, but is Cathy investing in this example?

Mr Chant—We don't know.

Senator WONG—So one has to make the assumption.

Mr Chant—That is right. What we are saying is that if you are going to put in an example then it should be an example which is fairly indicative of the way people invest.

Senator WONG—Thank you, I understand.

CHAIRMAN—Are there any further questions?

Senator CONROY—So without the single bottom line figure can consumers compare different funds, in your view?

Mr Chant—No.

Senator CONROY—Would better fee disclosure impact on fees and charges in the industry be of help to consumers?

Mr Chant—Absolutely.

Senator CONROY—I wonder if you could take me through what are the key elements for a single bottom line figure. You might have heard me mention to previous witnesses, you know, I look at it from the point of view of total cost to customer. In your view, is that captured in the ASIC model? Is that captured in your model? Could you walk us through that?

Mr Chant—We agree with you that the total cost to the consumer is what you should be looking at, and it is exactly what we are doing here. If you turn to page 2 there is a table that says, 'Bottom line costs' and it gives a range there and it shows for an average account balance of $10,000 and for an average account balance of $50,000.

Senator CONROY—Which page is that?

Mr Chant—Sorry, it is page 3. You will see a table in the middle of the page. What that means is that we are saying, typically with superannuation funds there will be a member fee—a flat fee. Then there may well be an administration fee which is a percentage of assets, so we include the flat fee, the administration fee and the investment fee. In a couple of them here, at the bottom where we have got 'Retail master trusts' we also include the contribution fee. We agree totally that fees should be what the all-up cost is of all of these things, so in these figures that is what we attempt to do.

CHAIRMAN—Where do you place fees as an issue of importance as against the investment performance of the fund? If people, particularly upfront in making the investment at entry point, just focus on the fees and they are not comparing investment performance, is there a danger they are actually going to lose out?

Mr Chant—First of all, fees are known so you can calculate them; with investment performance it is not known. All of those clients I mentioned earlier on, the advice that we give them we say that when you are assessing a superannuation fund there are several factors that you look at, and one of them is investments, which incorporates investment performance. In our sort of equation that represents between 40 and 50 per cent of the total equation and we say charges represent about 15 per cent. When we advise a client, we are saying that the most important thing is investments, and when we talk about investments, we say to them we are really only talking about the multimanager product investments, not the single manager product investments, because most people are not invested in single manager investments, it is only in

the retail market that tends to happen where there is an adviser attached. So we get them to concentrate on that multimanager product and then we say to them, 'If you are interested in the multimanager product, what you should be interested in is the process in choosing those managers—who is the consultant and what is the process that they have.' That is where the bulk of our effort is directed. Charges only, we estimate at about 15 per cent of the total equation.

CHAIRMAN—Charges are at 15 per cent; investment performance, you said, 50, was it?

Mr Chant—We would say investments, and when we look at investments, say it is 45 per cent, the main thing that we look at in investments is who the underlying consultant is or who is the investment team, and performance is only a small part of that 45 per cent. It might be about 10 per cent of the 45 per cent.

CHAIRMAN—What is the other 40 per cent?

Mr Chant—The other 40 per cent is: there is 5 per cent on what we call 'organisational issues', which is probably governance, which leaves us with 35. We then have something like 7½ per cent on insurance matters, that brings you down to about 27½ per cent. And that 27½ per cent we break up into administration, employer services and member services, and let us just say it is equal in each case. That is the way we analyse a superannuation fund.

Senator CONROY—You would have heard some of the arguments from some people in the industry that disclosure of entry and exit fees should not be included in the model, as sometimes these fees may be waived. Should consumers be entitled to know what these fees potentially are? What is your view on that?

Mr Chant—We think that certainly they should know what the maximum is, and they should know that it is possible to negotiate those fees. Most consumers, though—

Senator CONROY—What bargaining power does the average consumer have when it comes to saying, 'I want to waive this one'?

Mr Chant—Very little.

Senator CONROY—That is the reality. Some very financially savvy people may understand this and have the dollars that they are putting into the scheme to be able to say, 'For volume I am demanding a bit of a waiver here,' but for the average punter not much chance?

Mr Chant—That is correct; very little chance.

Senator CONROY—How important is disclosure of adviser commission?

Mr Chant—We think it is fundamental that it be disclosed.

Senator CONROY—You would have heard me ask ASFA this question, but I am interested in your response as well. Some in the industry would say that a single bottom line fee model may be misleading because it does not show the actual fees paid by the consumer. How would you respond to that?

Mr Chant—We would totally disagree. And if you think about it, the two tables that I have taken you through are basically saying that most Australians are invested in a particular way and so it is reasonable as a starting point for comparison to say, 'Let's look at those costs.' Each individual may well be different but there has to be a starting point, there has to be a stake in the ground. And we are saying there is a very public stake in the ground already, so why not use it. APRA publish those figures every quarter. They have been available for years, and they are a very good starting point.

Senator CONROY—In his 2002 report Professor Ramsey said that a 1 per cent increase in a fund's annual fees and charges can reduce an investor's final account balance in the fund by 18 per cent after 20 years. In your view, do consumers understand that fees and charges have a cumulative effect on future benefits?

Mr Chant—The short answer is yes, but when you actually do those projections for them I wonder whether people really do understand it. Seven years ago when we started our business we made a conscious decision not to do the projections out over long periods of time. We made a conscious decision to say, 'Look, people understand a sort of one-year projection, in a sense, and if one fund has higher costs than another fund, people can extrapolate that over a long period of time there is going to be a big difference.' To actually do the calculations, for a lot of people it starts to get a little bit complex, but people can certainly understand a one-year figure and extrapolate.

Senator CONROY—Compounding is the heart and soul of the financial services industry. I remember a recent film called *The Bank*. You might have seen it. It started off with somebody going into a primary school to explain the concept of compound interest. I do not think we do that any more, but for a 1 per cent increase a reduction of 18 per cent is a pretty staggering amount. Professor Ramsey's methodology is right, isn't it?

Mr Chant—I have not looked at it, but I assume that it is. Extrapolating that over a long period of time, though, we would say that people do have choices during that period of time and they may change things. It can be a little bit misleading, in our view.

Senator CONROY—Why do you say that?

Mr Chant—You, for example, might say, 'I am quite happy to go into this particular fund now, even though it costs more than this other one, because there are certain benefits or services there that I happen to value.' But it doesn't mean I am going to value them the same way for the next 20 or 30 years. After a period of two or three years you may say, 'I am now happy to go somewhere else at a lower cost, because I have received the benefits that I wanted to receive' and education might be a good one. You might say, 'In this particular fund I am paying more, but the education they provide me with is much better, and I am prepared to pay for that. But after a period of time—when I am educated, in a sense—I do not necessarily have to pay those extra fees year in, year out.' You have the choice to change.

Senator CONROY—But I am interested in the true gravy train and how this whole system works. I put to you that I do not think people truly understand compound interest as well as you certainly do. I am not an expert, but this is where the real gravy is.

Mr Chant—I am sure it is.

CHAIRMAN—Mr Chant, thank you very much for your appearance before the committee.

[5.11 p.m.]

DUNNIN, Mr Alex, Director of Research, Rainmaker Information Pty Ltd

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee. We would consider such a request to move in camera. I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Dunnin—Thank you for the opportunity to appear here. First of all, I would like to set the scene in terms of what it is that this group called Rainmaker does. Since 1992, we have been collecting information about all aspects of the financial services industry, or at least all the aspects of it that we can figure out. We then package that information into a range of databases and publications and we try and use it to explain things, first of all, to ourselves and also to the industry and, increasingly, to people who use the industry. One thing about the beloved financial services industry is that we are very good at talking to ourselves; we are not very good at actually talking to people who use us. There have been fantastic developments in the last couple of years and I would like to think that Selecting Super is a good example of that. But there is obviously a long way to go. Effectively, Rainmaker is in the explaining game.

Part of explaining this and trying to understand things is that we have had to develop ways to compare and understand super funds. One of the tragedies about superannuation in its current form is that fundamentally it is a very simple product but this aura of complexity has evolved around it, which is a real shame. Superannuation is something we should all be really proud of. It should be something we should be really trying to get into, because it is a great way for consumers to build their wealth. In fact, they are going to make more money out of their super than out of their house—they really should try and understand that.

In doing all of this it is really important that we start to give consumers tools and techniques so that they can look at super funds and kick the tyres. One problem is that when we look at super we talk about compliance and tax structures and have the battle of the actuaries about one model versus another, 0.2 per cent here and 0.3 per cent there and compound and simple—all that sort of stuff. In lots of ways, consumers want to say, 'When I look at a super fund what have I got? I have a system where I have a range of investment solutions. I can do a lot of other things—I can get group insurance, discount home loans and good advice from a planner if I talk to the planner properly.' If we start to talk to people in a way that means they can actually compare and make sense of products they can really take advantage of super. We should be talking up that aspect of super, not talking it down.

When we talk about fee disclosure, one thing we have to try and work as hard as we possibly can to avoid is setting things up so the solution is actually worse than the problem. A good example of that is that when we start talking about disclosure of fees the last thing we want to be doing is providing more and more pages to PDSs to the point that we have to chop down another forest just to print a new PDS. Talking about table 1 in the ASIC guidelines or table 2, I have

even had people at conferences ask whether there should be a table 3. That is not the solution. We should be trying to get shorter PDSs, not longer PDSs.

We should also recognise that different funds have got different fee structures for people within the one fund. I can join a super fund and because, say, some people are earning more money than me or have more money in the fund than I have, we can have totally different fee positions even though we are in the one super fund. In that sense, putting in a single, one-size-fits-all estimate of fees can actually be misleading.

I think what we need to probably start to say to people is, 'Depending on your situation, if you join this way, this is what it looks like. If you join that way, that's what it looks like.' So maybe part of this debate is really about improving the standard of member statements. As a general rule, I think some funds have got a lot to learn about improving member statements. In fact, with Rainmaker Selecting Super, a lot of the feedback we get from employers and, increasingly, consumers is that they just do not understand their member statements. But, having said that, I think we have a pretty high standard on how we judge superannuation. I am still trying to properly understand my Telstra bill, and I have actually written a few letters to a few newspapers and I have had their marketing people on the phone to me about it several times, but I still cannot work it out and I think sometimes we probably judge super a little bit too harshly. But there are a lot of funds out there who have got a real technological edge with their administration and already they are taking what I think is pretty good initiative and decomposing the fees, giving members and their investors a simple explanation of fees, and I think they should be given credit for that.

Also when we talk about disclosure of fees and charges, percentages or dollars, we want to get away from these debates that cheap is good and expensive is bad. We do not buy cars and houses like that, and I do not think we should talk about buying super like that. For example, in some of the research that Rainmaker has done we have demonstrated fairly simply, and we have not had too much contention about this, that when you pay fees to your super fund, your fees are not buying investment return. What you are fees are generally buying is investment flexibility, and I think there is probably a little bit of misunderstanding at times that we think, 'If I'm going to pay a 1 per cent fee to my super fund, that means I am going to get a 20 per cent return.' It does not work like that. The more I pay in fees usually means the more services, the more flexibility, the more potential to do things. And when we start talking about superannuation as a product, I think we tend to cut through a lot of these debates about compliance standards for fees and charges.

Something else that would also help, I would suggest, would be trying to standardise some of the terms. I sometimes get a little bit carried away on this topic, but there is a little bit of opportunity for people to switch fees versus costs around, and there are some good examples of a couple of funds at the moment where they have said, 'We are going to get rid of all of our fees,' so when they go to the page in the PDS that says 'fees', they are just going to write 'nil', and it is going to be legitimate and perfectly valid. However, they are still going to have those same expenses, but it is on the cost side. And the funds are doing it for all the right reasons. They just think the members do not understand it, but I think that sort of reflects that there is a little bit of subterfuge going on. Another example, and previous speakers have touched on this, is that some funds can say, 'Our fees are just a dollar week.' They are paying an investment fee, so why don't they just talk about it? But it is called a cost because it is taken out at the overall level, and

I would suggest those semantic differences are things we should be trying to avoid. I might just leave it there.

Senator CONROY—You have heard me talk about what I am interested in actually getting through to consumers, which is the total cost to the consumer. You make the point in your submission:

... disclosure of fees in both dollar and percentage points therefore requires either generic member assumptions and/or personalised information in member statements. Progressive super fund and platform administrators are already gearing up to provide this information as an opportunity to showcase technological advances.

Which I think you mentioned just then. Could you advise the committee why some funds and platform administrators can provide personalised fee quotations and others cannot?

Mr Dunnin—I think it comes down to the technological systems, because the only thing that would stop a fund doing it would be that some funds are probably trying to gear up their IT and are not quite in a position. There are also debates within funds about whether it is a fee or it is a cost. So in some cases you can say, 'If I have to disclose the fees that my members are paying, I might sincerely believe that this is a cost that is paid at the overall level, it does not come out of individual accounts, so it does not come into the equation,' and I think that is one reason why we need to level the playing field here.

Senator CONROY—Sure. If I can just take you to the mortgage broking industry, two big mortgage brokers advertise nationally and they like to put indicative figures in the newspaper ads saying, 'I am ½ per cent cheaper.' But the real difference is that one of them outsources its legals and one of them does not and, therefore, the outsourced one does not claim that it is a cost to the member. It is completely fanciful because ultimately the consumer is paying for it. What you have described is this happening quite regularly in your industry—subterfuge is the word you used. What is the best way to stop the subterfuge?

Mr Dunnin—I think it comes back to this: when you have discussions with people in Treasury and you draw their attention to this distinction, they do not quite understand what you are saying. I think we had this conversation when I spoke to the committee two years ago. We talk about cost, but are we talking about the cost to the fund or the cost to the member? I think that is ill-defined. I know I am being really semantic, but it does crop up.

Senator CONROY—No, you are not. It is very important. You are not being semantic at all. This is one of the key arguments in the industry.

Mr Dunnin—I think it comes down to those sorts of issues. I think we should blow away that distinction, focusing on the total cost to the consumer. We have talked about that and I quite like that. Rainmaker are not in a position to collect total costs to the consumer, for the simple reason that we cannot decompose all the below-line costs. Picking up on some previous points, one issue that crops up here is that funds can put some of their costs within the calculation of unit prices and so on, and we just cannot get to that figure because we cannot decompose the annual statements. That is not an issue of, say, master trusts and industry funds; that is an issue that affects, I think, all funds in all ways.

Senator CONROY—You have developed what you call a total expense ratio fee calculation. How does that differ from the OMC, which ASIC and others in the industry are kicking around?

Mr Dunnin—We think it just goes one step beyond the OMC. We have set it up so consumers and employers, or anyone hitting it, can just say, 'Well, hang on, I think I've got $22,000 in my superannuation account and I am earning $43,000 a year. Just applying the nine per cent SG says how much I am putting in, so if there is an entry fee it will then multiply that out.' The member can then type in what their annual member fee is and they can type in what their annual investment fee is. We try and bypass debates about single manager, multimanager and all those sorts of issues. It just works out what the situation is as it applies to them.

Senator CONROY—Some in the industry, as you have heard me say to other witnesses, would say that a single fee model may be misleading because it does not show the actual fees paid by the consumer. Is that a valid criticism?

Mr Dunnin—A single, one-size-catches-all number would be misleading. I think you need to recognise that funds have got ranges on their fees. The way that we handle this at Rainmaker, when we are talking to our readers and anyone who is interested in talking to us, is to talk about fee ranges. So if someone can join a fund and have the contribution fees waived, we will say, 'In the best case scenario you are paying nil entry fee, so it multiplies through and your total fee might be, say, one per cent. But if you're going to pay the higher entry fee then the fee might be 1.4 per cent. So your fees can range from one to 1.4.' We tend to focus on what applies in particular situations. We do generic examples for people on $10,000, $50,000 and $100,000, depending on the case. So I think it can be handled that way.

Senator CONROY—You mention in your submission:

Sadly, many of the stumbling blocks to finally resolving these issues are largely unchanged from what they were many years ago when the initial debate started.

What are the stumbling blocks?

Mr Dunnin—When we talk to different players, we are still debating some of the terminology. Are we talking about investment fees or investment costs? Some organisations and some products use terms such as 'investment management', some talk about 'investment administration', some talk about 'asset administration', some talk about 'plan fees' and some talk about 'member fees'. In industry funds, when we say 'administration costs', those fees actually mean policy fees when you are talking to, say, a commercial master trust. We also have debates about what the words 'fees' and 'costs' mean. We have debates about what the term 'MER' actually means. In some cases it means a total fee estimate; in other cases it just tends to mean the investment related component.

Also I think there is a little bit of an issue in talking about disclosure. There will be funds who have massive disclosure—they have got web sites, member booklets, prospectuses, fee booklets and probably 10 or 20 pages where they will talk about all of the impacts of and the issues concerning fees. I think we are confusing the idea of more disclosure, meaning more information, with the idea of providing, if you like, a simple piece of information that people can react to. Reflecting that, Rainmaker, through our Selecting Super subsidiaries, do ratings of

super funds. We place a lot of credence upon funds who describe their fees in standardised formats in a single place. I think breaking fees up, to use an example, in page 20, page 73 and page 418 of the documents is not acceptable.

Senator CONROY—You heard Mr Bailey speak earlier; I think you were here. He described the powerful vested interests as having prevented better disclosure for consumers. Do you agree?

Mr Dunnin—Mr Bailey was very passionate. I would not go so far as to say 'powerful vested interests'. I think it often comes back to people just thinking about things differently. I also tend to believe that consumers are a lot smarter than we give them credit for; I do not think we need to—

Senator CONROY—Not according to the consumer testing that has been done.

Mr Dunnin—That is probably reinforced by the fact that I cannot figure out my Telstra bill, so I will not debate that one. But superannuation products can be quite complex, and if you try and present so-called simple fee models that everyone can understand it is going to be pretty tough. Most consumers watch *A Current Affair*. I do not watch *A Current Affair*, so it is going to be hard coming up with models everyone understands. I would suggest most people do not know how to program their DVD player.

Senator CONROY—But shouldn't the point be to provide one that most consumers do understand?

Mr Dunnin—Yes, I think so. That is why we need to provide tools to people so they can make those choices and they can make basic decisions, but I also think that trying to say that every fund is the same under every circumstance is equally misleading. One of the things that we are really starting to see, particularly in superannuation funds, is the recognition that different funds are different in catering for the different segments of the market. A good example is that there are funds out there that have three investment options; they are nice, simple, streamlined products. Equally, there are funds out there that have 150, 250, 400 investment options and you might ask why anyone would want to go to those funds. It is a fair question, but people go to those funds because they want a lot of investment flexibility. That is how some people think—they want the ability to chose AMP to run their Australian shares. Equally, there are people who do not want to make that choice—they just want to put money in a fund, set and forget. Because there are those differences, I think trying to bunch all of those funds into one simple number is going to get a little difficult. We are forgetting the fact that there are BMW7s and there are Hyundai Excels; they are different.

Senator CONROY—So you are not in favour of price competition?

Mr Dunnin—I am in favour of price competition but—

Senator CONROY—Just not comparable price competition?

Mr Dunnin—I think you have got to realise that there are different prices for different services.

Senator CONROY—Sure, but isn't the point to be able to compare price and service? If you cannot compare price—

Mr Dunnin—Yes, I agree with you.

Senator CONROY—If you cannot compare price then how do you know you are making an informed choice about price and service?

Mr Dunnin—I agree: you need to be able to compare price. We go to supermarkets and we go to car yards to compare prices, but in comparing prices we are also saying that we are matching a price against a value proposition. We need to recognise that that happens as well.

Senator CONROY—You made the point earlier that you did not think people bought a car on the basis of price. I am a little staggered by that concept. I would have thought that people do compare relatively-like products—say, a Holden Commodore and a Ford Falcon.

Mr Dunnin—Yes, for relatively-like products—which means they are bunching up price against the service level. If everyone bought a car purely based on price, we would all be driving Hyundai Excels.

Senator CONROY—I do not think that is quite right. People are able to make a reasonable comparison between a Ford Falcon and a Holden Commodore even though they are not priced the same, but the bottom line is that they have to have a price to be able to do that.

Mr Dunnin—Yes, I agree.

Senator CONROY—There are lots of options—sunroofs and mag wheels—and somehow those consumers are still able to make a choice based around price. Fuel consumption is a confusing concept too, but they are able to make a comparison. They have a price to start as a basis of comparison between a Ford and a Holden. What we are trying to achieve is a sense of the total cost to the consumer so they can have a price comparison and then combine that with a service comparison.

Mr Dunnin—Yes, I agree with what you are saying.

Senator WONG—The wording of the regulations refers to 'fees, charges or expenses'. Have you considered that and whether that deals, at least in this area, with your concern about shifting from fee to cost?

Mr Dunnin—I have considered that, but what we are doing is looking at the way funds are operating based on what they are telling us. We are looking at their documents—

Senator WONG—Yes, I understand that.

Mr Dunnin—We are trying to make sense of what the funds are actually saying. We are seeing funds, if you like, waive their fees. I have been to seminars where—

Senator WONG—Mr Dunnin, I understand that is your evidence. My question is: does the current format of the regulations deal with that issue or not?

Mr Dunnin—I would say it does, but I also think there is a perception that there is a difference between fees and costs amongst the funds themselves, amongst certain players of the funds.

Senator WONG—And arguably amongst consumers, that you might get away with calling something a cost. So how would we deal with that?

Mr Dunnin—I think what we have probably got to start to say is that we are talking about, say, anything that comes off the gross return.

Senator WONG—And say that all of that should be included in disclosure?

Mr Dunnin—Yes.

Senator WONG—Even allocating. I notice that in your submission you talked about various categories of costs and the different terminology which is used depending on what sort of product you are getting. Would you see any benefit in us putting something in like that, something that said, 'All of these are deemed to be this,' or that they should be classed similarly?

Mr Dunnin—Some of the feedback we get from a range of players is that if, for all the right reasons, they are trying work out what they would call their management expense ratio—

Senator CONROY—How about some feedback from the consumers rather a range of players?

Mr Dunnin—I have got to admit we probably spend more time talking to funds and now employers than we do directly to consumers, but that is changing. We get probably 30 or 40 emails from consumers a week, so we are getting there. When we find that a fund is trying to generally, for all the right reasons, work out its management expense ratio, often they are not sure what they should be including. You might think that does not make any sense, but they are the questions they ask.

Senator CONROY—This is the smartest, richest industry in the world, Mr Dunnin; I am shocked to find they are so confused.

Mr Dunnin—They are confused from time to time. You can look at how we work out investment returns. I have gone to meetings and a range of industry associations, and there are still people trying to work out how you calculate the investment return. I think cost is even more curly.

CHAIRMAN—Thank you very much, Mr Dunnin.

[5.32 p.m.]

WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer, Financial Services, Australian Consumers Association

CHAIRMAN—The committee prefers that all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to respond to in private, you may request that of the committee and we would consider such a request to move into camera. We have before us the written submission which has been lodged by the ACA, which we have numbered 12. Are there any alterations or additions you want to make to the written submission at this stage?

Ms Wolthuizen—I would like to make some additions if I can intrude on some of the time of the committee just to add some additional material, particularly relating to the context of this debate and the importance of realising that this debate is not unique to Australia. It is something that is happening in a number of jurisdictions and also at the international regulatory level.

CHAIRMAN—This is written material you have to lodge with us?

Ms Wolthuizen—I am just going to read it out if that is okay.

CHAIRMAN—Is this part of your opening statement?

Ms Wolthuizen—Yes.

CHAIRMAN—You can do that as part of your opening statement, which I now invite you to make.

Ms Wolthuizen—I would like to thank the committee for setting aside this time to consider what is a very important issue and I think one that is becoming of increasing importance to many Australian consumers as they become more and more aware of this particular issue. While our submission sets out the principles and requirements ACA believes are particularly important to meaningful fee disclosure, I thought I would emphasise a couple of other issues.

The committee would be well aware of the different types of fees that many consumers are paying, the different factors that contribute to the levels of fees associated with different types of funds, particularly superannuation funds, and the very great differences that consumers can face in the cost of membership of different kinds of funds. We have been very much guided by the recent research conducted by Chant West and, of course, by Ageing Agendas commissioned by ASFA. ACA itself has obviously for a while taken a very strong interest in this, but we have not more recently done any comprehensive consumer testing. We do know that, when consumers are asked, they tend to indicate that safety of their investment or superannuation is a primary concern followed by adequacy, especially in the context of superannuation.

It is often argued that a fee is not the only factor that a consumer or investor should take into account when selecting a product, and we could not agree more. But it is hard to make an assessment of whether a product is good value for money—whether it is an investment or any

other type of product—or is going to be fit for purpose, and I think that is particularly important in the context of superannuation, where providing an adequate retirement income is something consumers are understandably particularly concerned about when looking at fees and charges information.

Adequacy has been an issue that the parliament has considered quite extensively. The former Senate Select Committee on Superannuation defined adequacy in 2003 on average earnings as a replacement rate of 70 per cent to 80 per cent of pre-retirement earnings—approximately 60 per cent to 65 per cent of gross pre-retirement earnings. More recently, ASFA and Westpac have commissioned research by the Social Policy Research Centre which updated weekly retirement budget targets to about $600 for a 70-year-old retiree.

We can run a mythical model superannuant through our online super fee calculator. Let us say it is a person who starts contributing at 20, works till they are 65 and has a year out of the work force at 25. The person's starting salary is $25,000 and they retire on $52,000, with a nine per cent contribution, 15 per cent contributions on tax and a six per cent earning rate. These are figures that you could obviously manipulate to suit different types of investor profiles. On a fund with one per cent fees, this person would accumulate just over $435,000 upon retirement. They would pay about $161,000 in fees and have 20 years of annuity at just shy of $38,000 a year. On a fund with three per cent fees, all other factors being the same, they are looking at an accumulation of $265,000, $311,600 in fees and 20 years annuity at $23,135 a year. There are two points that immediately arise out of that. The first is that the person in the three per cent fund will pay more in fees than they will accumulate by the time they retire. With the one per cent fee fund, both adequacy tests will be met; with the three per cent fund, both adequacy tests will be failed.

This highlights the importance of fees. Sure, they are not the only factor and there will be many people for whom the fee is not going to be the most important consideration. They may have other means of providing for their post-retirement income. It is not just about saying to people, 'Go out and choose a vanilla low-fee fund.' But it does highlight that in many cases it is going to be a much more basic test of fitness for purpose—whether or not people are actually going to have adequate funds to retire on.

This is something that at the international level is becoming increasingly recognised. The international organisation of securities regulators has published two recent papers on fees and commissions in investment schemes, both highlighting the importance of fee disclosure as a starting principle, not only to existing fund members but to prospective fund members, and saying that enabling an investor to understand cost structure and make comparisons is a fundamental consideration in regulating the area of fees and commissions disclosure.

We know in Australia, from the ASFA-commissioned Ageing Agendas research and from the ANZ financial literacy survey, that consumers struggle to understand fees and commissions on many investment and superannuation products. When ACA and ASIC conducted the financial planning survey, even our panel of experts found it difficult in many cases to try and unravel the fee and cost structures of the plans and investments they were presented with as part of that assessment process. When we at ACA have tried to structure or devise and develop better fee disclosure principles and models for consumers, we have always been guided by what people can actually understand. Our interest is not what is convenient for industry to provide. Again, I

would highlight that that seems to be an increasingly prevailing approach taken at the international regulatory level.

You would have heard this afternoon discussion of the Ageing Agendas research, particularly the fact that people struggle with the application of percentages and with the comparison of dollar figures and percentages. Percentages do seem to present difficulties for people. Tables, clear headings, standardised format, standardised terminology all provide assistance to consumers to aid their understanding. It does seem to us that that is a reasonable, straightforward direction for industry to take. That is not a uniform approach, obviously, within industry and I do note that there does seem to be a universal commitment to meaningful fee disclosure; however, there are differences on how feasible and possible that might be. At this point I would like to point out that in other jurisdictions, regulators and industry are also grappling with that particular problem.

But when we look at Canada and the United States, for example, they have already introduced standardised fee tables. In the US example, standardised fee tables have been in place since 1998. In Canada, Sweden, the UK and the US, they now require an all-in-one fee measure, with accompanying illustrative examples to demonstrate fees and commissions to investors. In the US, there is now further work being done to build on the standardised fee table model, recognising that dollar based disclosure can be of greater assistance to consumers in helping them to understand, in the words of the SEC, 'in very practical terms the impact of fund expenses on the value of their investments'.

I also point out that, in three member jurisdictions of IOSCO, there has been capping for certain types of fees. In Ireland redemption charges in retail funds are capped at three per cent; in Spain there are precise caps set on certain fees; and in the US there are limits on sales loads and distribution fees. In France, Hong Kong, Jersey and Portugal there are warnings on the levels of fees and commissions in documents describing investment schemes, and in Luxembourg the regulator has encouraged fund operators to lower fees when they consider that the level is appropriate. I make that point to indicate that, while we are discussing disclosure as the best way of promoting competition, transparency and investor understanding, in some jurisdictions regulators have taken a further step and are exercising de facto control over the actual fees being set. I make that point to illustrate that, if industry today or in the near future cannot fit their complex fee and product structures into meaningful disclosure, there are precedents overseas for greater regulation.

I would urge the committee and the parliament to consider adopting a similarly stringent approach. We are talking about people's retirement incomes. At the government level we already have recognition that, in many cases, people's retirement savings are not going to be adequate by the time they retire. Sectors of the financial services industry are benefiting at the moment from a level of protection because of the opacity of fee disclosure that is simply not available to most other areas of the Australian or international economy.

I would like to finish by again referring to the international approach. An IOSCO paper of last month emphasised that ensuring transparency in this area encourages competition amongst fund operators, and competition leads to a more efficient market, from which investors eventually benefit. I think that is an excellent objective to strive for and one which I would hope that the industry and parliament are able to bring about very quickly.

Senator CONROY—IOSCO recently produced a paper, which you have just referred to. It was released in February, so it is very recent. I wonder whether you have had a chance to look at it yet and whether you have any views on it.

Ms Wolthuizen—I have not had a chance to read all of it. This is a consultation document for best practice standards in fee disclosure. What strikes me about this particular document is the recognition that disclosure must be devised from the perspective of the investor—what is meaningful from an investor's point of view as to fees and expenses. The part I have in front of me says:

> Information on fees and expenses should be disclosed in a way that allows investors to make informed decisions about whether they wish to invest in a fund and thereby accept a particular level of costs.

It is not expressed in terms of what industry can do or what is feasible for industry or what exceptions you should incorporate to allow for particularly complex structures in particular products. It simply says that people need to know this information in order to make a choice and the onus is on industry to provide that.

Senator CONROY—Do you believe that a single bottom-line figure for fees and charges would provide a mechanism to 'kick the tyres'—as I think Mr Dunnin referred to it—of different products?

Ms Wolthuizen—That is certainly what people would look for in most products and services, particularly in the area of financial services—super funds and investment funds. Judging from the work that has been done in comprehension testing and consumer testing, the responses from participants in those surveys clearly indicate that they appreciate having that information in a format that they can readily understand, and that tends to be in dollar terms, and one which they can then compare with another product. It is not going to give them all the information—we would not want people to simply be making a choice on the basis of the fee—but how else do you assess value for money if you do not actually know how much money you are going to be paying for a particular product?

Senator CONROY—That is a fair point. Do you support ASFA's single bottom-line fee model?

Ms Wolthuizen—Again, we are generally guided by how consumers react. There are advocates of a percentage figure, and that has some advantages in terms of simplicity; but, if consumers do not understand it, it is not really going to be of much use. It may have the advantage of being a kind of one-size-fits-all measure, but if people cannot actually apply it, then there is no point in reverting to that. It works in the context of home loans, but home loans are well understood financial products and people are used to the structure of home loans. But even in the context of home loans, we have had to bring about an AAPR. So trying to use a single bottom line percentage figure to impart years worth of understanding and experience with products that might exist in other areas of financial services is very difficult, and clearly people like a dollar based figure that gives them a good indication of the cost of a fund.

Senator CONROY—The ASFA model for single bottom line fee disclosure does two things: it provides a total fees column and then it applies that to the member benefit. Do you think both steps are required?

Ms Wolthuizen—Yes, I do. When ACA first developed our fee disclosure table we also wanted to have a column, 'no fees charged,' so people could see just how much they would have based on those assumptions if fees were not charged at all. But I think having those two columns is important.

Senator CONROY—And you would support including entry and exit fees?

Ms Wolthuizen—Absolutely. I think the Chant West research demonstrates it is a one per cent to 1.5 per cent difference in the cost of an investment, and that is an extraordinary amount. To even contemplate leaving that out I think would be misleading in the extreme.

Senator CONROY—Some in the industry, as you would be aware, argue that disclosure of entry and exit fees should not be included as sometimes these fees may be waived. Are you aware of many ordinary consumers that have been able to successfully negotiate to waive them?

Ms Wolthuizen—I would like to see the figures on how many people do manage to negotiate to have those waived, particularly when they do not have very large amounts to invest, so that would be most average investors. Beyond that, I think most people would anticipate that if a fee is charged and you can negotiate to bring it down, you start from an assumption that the fee is going to be charged. If we want people to start negotiating with planners or with funds about the cost of investing, surely you put up what they could be charged, and then they can start questioning certain fee levels and seeking a better deal.

Senator CONROY—You would be aware that ASIC has provided an OMC, or their fee table. Is the single bottom line fee model more preferably to the ASIC OMC?

Ms Wolthuizen—I do not think ACA has ever viewed the two as being mutually exclusive, given the complexity of this area. When we participated in consultations around the ASIC fee table, it was never on the understanding that that would be it. We have always sought that sort of up-front, single bottom line figure as the most important element of fee disclosure. I think you would probably say the next most important will be the periodic statement that someone receives showing how much they have paid, to the decimal point. The ASIC fee table has its value as a kind of glossary of fees that can be charged, and ensuring that it is an accurate reflection of the fees charged to a fund is important; but I do not think it could ever be the be-all and end-all of fee disclosure in these sorts of products.

Senator CONROY—ASFA's CEO said the following in relation to the ASIC fee model:

> Our consumer testing showed that it could not be understood by ordinary fund members. It is not enough to get the experts together to design a fee disclosure model unless you put in place the reality checks to ensure ordinary people understand it.

In your view, do consumers understand the ASIC fee table, and what it produces?

Ms Wolthuizen—Clearly from the research, the participants in the survey were not able to use it to ascertain the cost of investing with a particular product. But I think that would be the wrong expectation to have of that particular form of disclosure, and that is why we would be very disappointed if the ASIC fee table, as it currently stands, is all that consumers had to go on—if we do not implement a single up-front form of disclosure that they can use in conjunction with that kind of fee table. Ultimately, you would expect that that fee table might be one of the lesser used elements of fee disclosure. It will be useful; it has its place. But I do not think we can ever expect it to take the place of that up-front measure. It is further information and it is relevant, but it should not be everything.

Senator CONROY—You also mention that in addition to providing consumers with a single bottom line figure and in addition to a revised ASIC fee template, you believe that periodic statements should show how much has been paid in standardised dollar terms. Could you advise the committee how disclosure should be standardised?

Ms Wolthuizen—There should be standard terminology. Do you mean for periodic statements?

Senator CONROY—Yes.

Ms Wolthuizen—I suppose there should be similar principles to those that would apply elsewhere in disclosure—you would use the same terms and the same format for the periodic statements that are sent out to people. We are dealing with products that are extremely complex. People are not used to reading these statements or understanding the implications, the calculations and the elements behind the different costs they are paying. We know that educating people in the area of financial literacy is a very great undertaking and that there is a lot to be done within the Australian population.

Why we would have a system where we require people to contribute nine per cent of their salary to superannuation and to basically be reliant in their post-retirement life on the earnings from the accumulation of that contribution over their working life and then not take a more interventionist approach on the information people are provided with—let alone discuss things like capping costs—and ensure people are presented with that information in a manner they understand when they are going into, during and when they make decisions about exiting the fund seems to me to make no sense in a consumer rights or a public policy context. It is so important to have that standardised disclosure for periodic statements so that people become used to a particular form and it is a form that they can understand.

Senator CONROY—I think you mentioned earlier some calculations you had done, which sounded similar to what Professor Ramsay said—that is, that a one per cent increase in a fund's annual fees and charges can reduce an investor's final account balance in the fund by 18 per cent after 20 years. That seems about consistent with the evidence you gave in your opening statement. In your view, do consumers fully understand that fees and charges have such a cumulative effect on future benefits?

Ms Wolthuizen—No, I do not think so. Just off the top of my head, the ANZ financial literacy survey seemed to indicate that a lot of consumers think these fees are only charged on a performance basis. Whenever we discuss it publicly or with consumers, the reaction does tend to

be one of shock and horror when they realise that what sounds like a very small amount—you know, one per cent, three per cent or four per cent—can have such an enormous impact on their earnings. People seem to have some understanding of compound interest but do not seem to understand that it can work the other way when it comes to fees.

Senator CONROY—We have had the ANZ financial literacy survey results recently and the government have just announced a financial literacy program. Does that say to you that consumers can fully understand the myriad mazes—a term some other witnesses have used—of fees and charges and things that are called anything but a fee or a charge?

Ms Wolthuizen—I might have to go back and check to see whether I am right, but I do recall from the ANZ financial literacy survey that the area of investments in superannuation was the worst-performing in terms of consumer comprehension and financial literacy. Whether that was true across all cohorts, I cannot remember, but from recollection I think it was. A lot is being heaped on disclosure and a lot of responsibility is being heaped on consumers to better understand the investments they have and the superannuation arrangements that have. We are reliant on people's understanding to maximise their earnings off those investments and to be self-reliant throughout their working life and beyond. I think in many cases we are overestimating the capacity of people to develop that kind of expertise and understanding, but at the very least we should give them the basic tools in straightforward, easily understood information.

Senator CONROY—I am interested in the point you made a little earlier that consumers often think that the one per cent, the two per cent or the three per cent relates to the performance of the investment rather than to the total amount of money that they originally put in. It is a fascinating concept. I have often pondered why the financial services industry is one of the few that does not get paid on the basis of performance, and I guess consumers are confused by that point.

Ms Wolthuizen—Yes. Those that did work out that it was not based on performance, that they were paying that fee even where their fund or their investment did poorly or suffered a loss, certainly let us know about that and I am sure they let the funds they were members of know about it too.

Senator CONROY—Thanks very much.

CHAIRMAN—Thanks very much, Ms Wolthuizen, for appearing before the committee.

[5.55 p.m.]

LANNON, Mr Michael, Managing Director, 20/20 Funds DirectInvest

CHAIRMAN—I now welcome Mr Michael Lannon from 20/20 Funds DirectInvest. The committee prefers that all evidence be given in public but, if at any stage of your evidence or answers to questions you wish to respond in private, you may request that of the committee and we would consider such a request to move in camera. We have before us your written submission, No. 8. Are there any alterations or additions you want to make to the written submission?

Mr Lannon—Probably a few additional comments but no real alterations.

CHAIRMAN—I invite you to make an opening statement, after which we will proceed to questions.

Mr Lannon—I have been an advocate of better disclosure of fees for many years now. One of the major issues to get lost in the debate is the differentiation between effective disclosure and legal disclosure. At the moment we have disclosure that is somewhat piecemeal. Financial planners disclose some fees and fund managers disclose some fees in the PDS; the average investor has no idea what fees they are paying. The only evidence I can offer in support of that is that last year RMIT did a study and roughly 30 per cent of Australians did not know they had superannuation, let alone what fees they were paying. So it is a big uphill battle.

When it comes to fee disclosure, what we are really looking at are the who, what, when, where, why and how. I will start with what fees should be disclosed. The simple answer is all fees. When I say all fees, some of the types of fees are: management fees on funds; expenses charged or expense recovery, which are sometimes included in the management fees and are sometimes additional; a trustee or single responsible entity fee; and administration fees. There are all forms of commissions that are paid to intermediaries—up-front commissions, trailing commissions and soft dollar commissions. Buy-sell spreads are another area. Investor A wants to buy a fund today and investor B wants to sell, and there is a spread of 1½ per cent between the buy-sell price. Rather than giving that to the fund, they swap and pocket the proceeds in between. That is another area that needs to be disclosed.

When should they be disclosed? At the time someone is making an investment and in a continuous manner on client statements. Basically, what happens in the front-end—disclosure of fees by the financial adviser—is very often a one-off disclosure. Who should be responsible for disclosure? The adviser? The fund manager? I think the fund managers are the people who have the majority of the data. They may actually collect the fees on behalf of financial planners—the entry fees, the trailing commissions and the new adviser service fee, which is a recently invented commission. At the same time, advisers should be responsible for disclosing their fees under the statement of advice in the current rules. The problem in that area is that ASIC is somewhat under-resourced to enforce it. I think there are 10 police and 16,000 planners. It is very difficult to enforce those regulations on advisers. I am sure it will try.

Where should they be disclosed? In the product disclosure statement? I can tell you from history that I could give 100 investors a product disclosure statement, and only a handful would read it. Is that their fault, buyer beware? Ultimately it is marketing and legal tied together. In the financial plans? You get a financial plan and it is there, but it is one page out of 80. In the statement of advice? Yes—under client statements on a continual basis is what I advocate. Why should all the fees be disclosed? Catherine gave an example of the effects of fees. My model is much simpler. Take a 20-year-old with a 40-year working life. The option is, instead of taking the escalating salary, they just make an average of $50,000 over the next 40 years. Five thousand dollars a year is contributed to super, so it is actually $56,000. If they paid two per cent a year in fees and earned eight per cent—typical long-term average returns in a growth type of fund—their fund would grow to $1,841,460. If they paid one per cent a year more in fees, their fund would only grow to $1,398,905—a difference of $442,555. That is the impact of the fee. As long as it is hidden, investors are oblivious to that fact.

Finally, how should fees be disclosed? In dollar terms, in percentage terms and alongside the returns. We talk about whether investors are getting value for money. If you require fund managers to put fees on the statements next to the returns and my return is three per cent and my fee is three per cent, that will raise eyebrows. By disclosing the fees in dollar terms on the statements, the investors will seek out value. It will definitely radically change this industry, because the fees are largely invisible. How they are disclosed and how they impact on your long-term retirement, I think is an education issue. For sheer impact, if you put them on a statement alongside the returns and the fees and the return is five per cent and your fees are three per cent, you start questioning why so much of your earnings are being taken away. That said, the statements are the key to ongoing disclosure, I believe, because clients get those and look at them whether they be semi-annually, with superannuation funds, or quarterly, with most investment funds. That is really all I have to say on that.

CHAIRMAN—Thank you very much. We will go to questions, Senator Conroy.

Senator CONROY—I am interested in that example you have just given, Mr Lannon. If they were required to put the fee in dollar terms and the return in dollar terms, it would become even more stark. What they would suddenly discover is that the fee is not on performance; the fee is on the capital plus the performance. In a very extreme example, you could have the fee being greater than the return in terms of performance.

Mr Lannon—I guess, instead of a percentage of your total funds it should be a percentage of your return. In the case I just gave you, it would be an eight per cent return or a nine per cent return, as one-ninth of your investment returns are going in fees. Most investors will understand that and will question it and that will create a competitive market environment for clients then to question fees.

I run a discount funds management operation. Fees are optional. Australians can buy most managed funds in this country without the upfront fees. All the up-front entry fees—whether it is Comsec or something like 20/20—can be rebated. The discount market share is about five per cent. In North America that market share is about 30 per cent and in the UK it is about 20 per cent. That indicates to me that people are not using discount services because they do not know they are paying the fees. My vested interest in appearing here today is that, if people know what fees they are paying, they will be rapidly changing their model. People today really cannot

distinguish between advice, performance and fees because, once you sign up, they are sort of invisible.

Senator CONROY—Your submission states:

The average Australian has no idea of what fees they are paying because of the range and type of fees that are changed and the lack of effective continuous disclosure.

You have heard some of the earlier evidence about that. In your view, consumers do not understand the fees and charges associated with investing in funds because of poor disclosure. Is it just poor disclosure?

Mr Lannon—Poor disclosure is one issue. What happens typically out here—and I will give you the example—is that the average person is bamboozled. When you walk in to see a financial adviser to get advice in an area where you have little or no knowledge—there are technical terms et cetera—you are trying to find someone you trust. Ultimately, when you leave you probably have about 400 pages of information—three or four prospectuses that are 60 pages long, a 100-page financial plan—and in there is the disclosure. It is just digesting that at the front end. Once they are disclosed there you have just got the annual prospectus to see the MER.

Prior to June this year and in the three years preceding there was an interesting three or four years in the market. It was interesting to watch investors focus on fees. We had some investors who were doing it themselves and had significant sums of money who left and went out to seek advice because they were questioning their ability to do it themselves. On the same level, we had people who were getting advice questioning what advice they were getting and what value and then deciding to do it themselves.

So I think, ultimately, to disclose the fees on the statement is easily forgotten. When paying fees you see a bottom line. Very often there is still a scenario where you can invest money in a fund where you put $10,000 in a fund that has a five per cent entry fee and, rather than seeing $9,500 invested at $1, and $500 commission, you see $10,000 at $1.05. It is hidden right there at the front end. It is up to the adviser to disclose it. The statement does not necessarily say you paid five per cent—it is a bit of a shock—and then you have a quarter or six months to make that up as a fund manager.

Senator CONROY—As you would be aware, some participants in the financial services industry believe that they should only have to disclose an ongoing management charge—an OMC—or a management expense ratio. In your view, is disclosure of an OMR or an MER sufficient? Does that give consumers what they need as opposed to what the producers want to give them?

Mr Lannon—Definitely not. Management expense ratio was one ongoing fee, and the definition that has been settled on gives a fair idea of the ongoing management charges. But, if you think of the industry as manufacturers, distributors and consumers, the manufacturers have been marginalised a bit by the distribution organisations, so they are usually selling wholesale funds. The distribution organisations create the master trusts and wrap accounts that are largely getting the market share, but the real change has been a move from what used to happen, which was churning. In the past, Joe down at the factory retired with the largest sum of money he ever

saw in his life—$300,000—and went to see a planner and bought a few funds, and every year a couple of them did well and the ones that did not got churned around.

Now people go into an all-encompassing product so they can swap around 400 options, but there is the introduction of a new fee called the adviser service fee. This is not the trailing commission or the up-front commission; this is the new adviser service fee that is the norm. It is one per cent, and in some cases up to two per cent. If you sign up for it, it becomes visible, but it is 'death by a thousand cuts'. A little bit comes out every month, but the actual impact of that is hard to imagine. If the statement is required to show the fees on an annualised basis at least once a year—'This is what fees you have paid; this is what you have earned'—you will radically transform the industry so that people receive value.

Senator CONROY—Your submission raises the following question, which has always perplexed me:

How is it that banks are responsible for disclosing every cent of fees charged on accounts on clients' statements yet the largely bank owned fund managers and advisory firms are able to receive billions of dollars annually in what are largely invisible fees.

Is it correct to say that in your view fund managers should be disclosing all fees and charges?

Mr Lannon—Very much so. Instead of it being a 'buyer beware' situation, if a consumer is educated, the professional standards will rise and the concept of whether or not you need advice throughout your entire life or at periods will come to the fore. I think people need advice when they initially start out on their plan and set some goals. During the accumulation phase of life, there is not a lot of advice you require in terms of ongoing. You get your plan set. People can be taught how to choose funds et cetera. As you graduate your superannuation into your pension stage, that is a very technical area and investors need advice.

So why are people paying for advice from the beginning till the end? The reason is that that is the way the industry is structured. It is intermediated and, over seven years, I have seen the difficulty of trying to go direct. What fund managers used to call channel conflict—being the direct players—is now referred to as channel diversification, because we have created some market share. It is interesting. In my view, investors need it put in front of them on their statement, and then they will vote with their feet.

Senator CONROY—Why aren't banks disclosing these invisible fees, in your view?

Mr Lannon—If you had $7 or $8 billion a year invisibly, you would not be putting your hand up to disclose it. I think basically the fact is that there would be a revolt. There is an argument that, if the fees and charges were disclosed, maybe that would discourage saving. I think that, if the fees and charges were disclosed, it might help develop a financial planning profession. I tell our clients: if you want to receive advice unbiased, go pay someone a fee for advice, not a commission. Pay them an up-front professional hourly based fee, and then you are employing them to work for you and you know that you are getting advice tailored to you, and they are not flogging you some product. That is the model that we need to evolve to, as a profession, in the financial services industry—so people pay in the same way as they would pay their accountant or their lawyer et cetera.

Senator CONROY—Your submission states that all fees for managed investments and super funds should be disclosed in dollar terms in the periodic statement. How would you standardise disclosure in the periodic statement to allow consumers to compare costs?

Mr Lannon—You would break it down into several things, depending on the product—administration fees, management fees and sales commissions—and you would say that these are the three main categories of fees. You can look at those versus other products: what are you paying as commission costs or management and administration fees—there is a bit of clouding with those terms, because some people call it an administration fee, some people call it a management fee and some lump them together.

Senator CONROY—In your view, should disclosure in the periodic statement of the fees paid be a requirement in addition to an indicative up-front fee measure in the PDS?

Mr Lannon—Disclosure in the PDS by all accounts can meet all kinds of legal requirements. But I would wager you could put a page in the centre or towards the back of the PDS that said, 'This product charges excessive fees' in bold letters, and nine out of 10 people would not see it.

Senator CONROY—So you would support disclosure in the periodic statement of fees as well?

Mr Lannon—Yes. The PDS has put it there so they are disclosed there—I definitely support it, but I see it as ineffective.

Senator CONROY—You are saying that the PDS is fundamentally ineffective?

Mr Lannon—The problem is that it is a marketing document, a legal document, that most people do not read.

Senator CONROY—Your submission says that most companies issue periodic statements at least semi-annually. Is semi-annually enough?

Mr Lannon—I think superannuation funds are required to do so semi-annually and investment funds quarterly. I never understood that difference. I would think quarterly statements would be more consistent.

Senator CONROY—Your submission states:

The financial services industry (banks, insurance companies and fund managers) is a very powerful lobby group and the industry groups that help shape the laws affecting investors have vested interests. The Investment and Financial Services Association is an association of fund managers. The Financial Planning Association is made up of financial advisers and is now dominated by the large bank owned advisory groups.

In your view, what impact do these vested interests have on fee disclosure?

Mr Lannon—I think there is a strong incentive for fund companies not to disclose all these fees. I call it the fee-fest. They collect them and make great profits and that is fine, and they are invisible. The banks have had their heyday of being beat up over fees and so they have moved

into the next lucrative category—fund management—by acquiring fund management companies, and those fees are invisible.

Senator CONROY—So who is looking after the investor or the consumer?

Mr Lannon—I think the Australian Consumers Association do a good job of putting their views forward. The Australian Shareholders Association is moving to create a managed fund area in that space, but ultimately consumers are left largely on their own to sort out what fees are there. So I do not think that anyone really has consumers' interests at the forefront other than those two associations. There is, I think, a managed funds association that may have some interest there.

CHAIRMAN—When you talk of it being more appropriate that people pay up-front fees for advice rather than through the commission structure, how would you relate that to sharebrokers who provide advice on a commission basis but it is a commission paid by the investor based on the turnover?

Mr Lannon—It is on the transaction statement, very clearly disclosed.

CHAIRMAN—So you have no objection to that sort of commission based fee?

Mr Lannon—I have no problem with people collecting commissions or fees—I am a businessman; collect what you can get, but disclose it. If you buy a car for $10,000, and the car salesman sold it for $20,000, good on you—that is commerce. But the context is that if the fees are invisible the consumer is disadvantaged. So by making the fees clearly visible, the industry then will be sorted because people will pay for value.

CHAIRMAN—Thank you very much, Mr Lannon, for your assistance to the committee this evening.

[6.15 p.m.]

DOYLE, Ms Suzanne, National Manager, Superannuation and Retirement Policy, AMP; Investment and Financial Services Association Ltd

DRUMMER, Mr Chris, Manager, Government Relations and Policy, MLC Ltd; Investment and Financial Services Association Ltd

FERGUSON, Ms Carole, Senior Legal Counsel, Colonial First State Investments; Investment and Financial Services Association Ltd

FRENCH, Mr Philip, Senior Policy Manager, Regulatory Affairs, Investment and Financial Services Association Ltd

RUBINSZTEIN, Ms Nicolette, General Manager, Office of the Chief Executive Officer, Colonial First State Investments; Investment and Financial Services Association Ltd

WELLS, Ms Jenifer, Head, Government and Regulatory Affairs, ING Australia Ltd; Investment and Financial Services Association Ltd

CHAIRMAN—The committee prefers that all evidence be given in public but, if at any stage of your evidence or answers to questions you wish to respond in private, you may request that of the committee and we will consider your request. The committee has before it your written submission, which we have numbered 10. Are there any alterations or additions you wish to make to that written submission?

Mr French—Not with respect to the subject of the hearing, as per the communications—the batches 6, 7 and 8 regulations. But some further comment on the subject of questioning this afternoon—the single fee measure, which we did not address in our submission—may be required.

CHAIRMAN—You can do that in your general statement. There are no actual written changes you wish to make to the submission?

Mr French—No.

CHAIRMAN—I invite one or several of you to make brief opening statements, at the conclusion of which we will move to questions.

Mr French—The subject of the hearing—the regulations and the draft regulations, particularly those on the issue of dollar disclosure—is of tremendous concern to all IFSA member companies, hence the strong showing today. We are very keen to address that and we are happy to take questions on that. It is our principal reason for coming in the first place, so I thank the representatives for appearing on that. One company also would like to be able to address some remarks to earlier evidence given specifically on it and its products, if that is all right with the chairman. With respect to the single fee model that has been discussed, which I

will come back to in the opening statement, I would like to say at the outset that the IFSA board of directors is in direct communication with the ASFA board of directors to look for common ground in this area, where there has been some disagreement for quite some time. I am advised by the IFSA chairman that they expect some progress to be made over the next few weeks.

In relation to the dollar disclosure issue—the batch 8 regulations in particular; there are no problems with batches 6 and 7, by the way—we would like to summarise our position. We believe that, if implemented in their present form, these would place an unreasonably heavy burden on industry, the regulator and, ultimately, consumers because of the costs involved. The current reasonably practicable test that is encompassed in the regulation for these dollar disclosure requirements encompasses the concept of what can reasonably be achieved at a given point in time, taking into account factors such as cost, industry standards, practice, the state of technology et cetera. We think that that is quite a reasonable way of doing it, whereas the not possible test as an absolute concept—if it can be done it must be done, regardless of cost or any other factor, such as detriment to providers or consumers—is a very difficult one for all concerned.

To require companies to prove by providing compelling reasons that it is not possible to do something will, we believe, if the regulations are implemented, set an impossible standard. So we submit that it would be fairer and more in keeping with the objectives of FSR to set a standard based on the provision, for example, of compelling reasons as to why dollar disclosure is not practicable, or not reasonably practicable. The compelling reasons we can probably come up with but not possible makes it very hard indeed. That is probably the major point of our submission, I would say.

In relation to periodic reporting, it is very much a function of the operating systems which underpin products and the ability of such systems to extract meaningful information about individual interest from numerous pooled investment vehicles. Industry is anxious to improve comprehensibility of periodic reporting, but its ability to move quickly is constrained by a number of factors, including the cost and difficulty of systems changes and the time taken to implement changes across multiple products and computer systems of various ages. At present, starting on that work is very difficult because there remain significant uncertainties as to the exact scope of the requirements.

The scope of application of the dollar disclosure requirements to periodic statements will remain in doubt as long as the meaning, for example, of the term ‘common fund’ is unclear. It appears to be understood in a variety of ways by industry and regulators. It is not clear, for example, whether it includes a life company statutory fund. If it does, it raises some pretty complex issues. Life companies operate different types of statutory funds and, in our view, it would be inappropriate to lump all such funds together. These funds have a mixture of funds belonging to shareholders, owners of participating policies—that is, life and endowment policies, policies with investment accounts and crediting rates—and owners of non-participating policies—some investment-type policies as well. So it gets very difficult to identify ‘common fund’ in these sorts of situations, and it is going to take a while to work out, we think.

We do not think it is possible to simply characterise all statutory funds as common funds. The only generalisation you can make about statutory funds is that it is unlikely or unusual if fees and charges can be attributed, even in a generalised way, to individual policies or financial

products, as described in the legislation. It is inaccurate and misleading to attempt to attach any particular fees, costs or expenses to those products, and there are no calculations that a life company can do to satisfy the requirements to disclose the fees, costs and expenses associated with the common funds provision, as it is currently formulated.

For unit link products, such as managed investments and certain accumulations of super, common fund charges vary from day to day, depending on account balances held by individual members. While it is not possible with existing systems to extract actual dollar amounts of individuals' contributions or proportions, industry is working overtime towards achieving dollar disclosure of common fund fees via the ongoing fee measure and average account balance based calculations. We will get there eventually, but it might take a little bit of time. Even the ability to provide estimates of individual contributions to common fund charges through the use of average account balances depends on the implementation of major system changes for most companies. This is just a very big resource issue and, as I say, quite large costs accrue.

Cost estimates for system changes required to implement that fairly simple solution, the average account balance solution, vary but range in IFSA member companies from $300,000 up to $2 million, depending on the number of different systems and platforms employed, and individual assessments as to what products are subject to the requirements. It will take approximately 20 weeks to upgrade even the most modern systems to be able to provide calculations based on average account balances, and that is from the time we have absolute certainty as to the requirements. For older systems, more time will be required, not to mention expenditure. For some older products it may not be possible, so our plea is more time please. On that we are at one with ASFA, and we agree with ASFA that 1 July 2005 would be reasonable, again, as per our submission. We are happy to take questions on those issues. We have some people able to speak to the detail.

With respect to the single fee measure that has been the subject of so much discussion this afternoon, IFSA has a single fee measure and supports the concept. It is called the ongoing fee measure. It replaces the MER and, as a standard, specifies the principles that IFSA member companies must adopt when calculating the OGFM both as to dollar amounts and percentages. That is IFSA standard No. 4 and I will table that document if I may. IFSA Standard No. 12 requires IFSA members to put in their PDSs their ASIC fee template. They must use that template as worked out by ASIC and all sections of industry to disclose all fees and charges. That is a requirement right across our membership. I will also table IFSA standard No. 12.

We are also of the view that a reliable single fee measure is a useful comparability tool. The former ongoing management charge that super had for 10 years, for example, from 1994—I think it was 1994—helped consumers compare products. We thought it was a pretty good measure; the OGFM is a better one. However, we do have problems with any single fee measure which purports to combine discretionary and ongoing fees. These can be misleading and unreliable. We do not rule out the possibility of one, but at this stage we have not seen one that is not unreliable. They are attractive to some sectors of industry where they might perceive a competitive advantage, or they might even be attractive to people who are not comfortable with the unbundling of fees as required with the ASIC fee table, but their heavy reliance on assumptions, projections and averages renders them misleading and potentially dangerous to unwary consumers, notwithstanding their superficial attractiveness because of their apparent simplicity.

The Chant West model, for example, includes contribution and withdrawal fees at maximum levels as stated in PDSs, not the levels that are actually charged to investors. That is misleading to start with. Simply using the maximum in the PDS when the fee is in fact negotiable does not reflect the true picture. The model uses an average total fee which includes maximum contributions and withdrawal fees, average account balances, a five-year term and an earning rate of seven or eight per cent. The concept is misleading in its simplistic treatment of entry or exit fees by amortising them over five years and assuming a seven per cent investment return assumption for which there is no justification. Most importantly, the model places a zero value on advice, rolling the cost of the advice service into the product with the result that products sold with advice and other services are disadvantaged by being compared directly with more basic products which do not come with those things.

For retail funds, entry fees are incurred as a result of the provision of advice, a service not provided by all funds. The methodology that has been described, the Chant West methodology, of including entry fees for retail products in that manner does not provide, in our view, for comparison of like with like. It places a zero value on the advice component that so many retail offerings provide as part of their value add. In our view, were such a fee disclosure model to be mandated, it would effectively see many retail consumers cut off from advice. Were they not prepared to pay an up-front fee they would, in effect, be left to base decisions on their reading of single fee calculations based on assumptions and magnified by the application of forward projections. In this, we believe we have very strong support from Professor Ian Ramsay in his report to ASIC on the subject when he said:

> I do not believe it is practical to disclose in a PDS a single global figure which contains all fees. As explained in more detail in part 6 of my report, some fees are discretionary in the sense that some investors may pay them while others may not. In these circumstances, to include such discretionary fees in a single global figure can be misleading. To come up with a single global figure which captures all fees may be impossible to do in any meaningful way. Some types of fees may be fixed dollar fees and an administration fee in a superannuation fund is often this type of fee. Other types of fees are typically fixed percentage fees of certain amounts such as the amount invested or the amount in the fund. To combine a fixed dollar fee and a percentage fee in a meaningful way is difficult and requires additional calculations.
>
> A more significant difficulty with endeavouring to have a single global figure is that some fees are mandatory while others are discretionary. For example, a fund may impose switching fees. This fee will, of course, only apply to those investors who actually switch. This means that a fee which is discretionary needs to be disclosed separately from those fees which are mandatory, otherwise the single global figure has the potential to be very misleading.
>
> A similar point can be made in relation to entry fees. These may also be discretionary to the extent to which some investors may pay the full fee relevant to a product while others may have all or part of the fee rebated. In other words, disclosure of a single global figure which captures all fees may have initial attractions, yet it can quickly be seen that a number of important fees would need to be disclosed separately.

That, in conclusion, is what the ASIC fee table does. It is what we do in our PDSs. We believe that the FSR legislation, with those enhancements, as negotiated with ASIC, should be given a chance to work and, in the meantime, we should be given a chance to continue to talk with other sectors of industry about further enhancements.

CHAIRMAN—Thank you, Mr French. You said there were a couple of other witnesses who wanted to make some brief comments.

Mr French—As was mentioned in earlier evidence, there is one company, AMP, which would like the opportunity to comment.

Ms Doyle—I was just wondering whether, before we get to that, Carole has some things to say.

Ms Ferguson—There has been very little discussion about the issue of periodic statements. I chair the IFSA committee which represents the members and deals with the matters that arise out of the periodic statement issues. Philip went through some of the concerns that we have. I just point out to the committee that this is a significant issue for our industry. We have laboured long and hard for some time to try to resolve some of these matters, and they are basically proving insurmountable in some cases.

The industry represents a wide number of different types of financial products and the definition of 'common fund' imposes on many of the members a difficulty in relation to whether they, in fact, are caught by the legislation as a starting point. Particularly in relation to life products, including annuities and participating policies, and also closed products, the new requirements impose an unreasonable burden on our industry. The issues that have come up also relate to what is a significant benefit—whether a significant benefit includes, for instance, access to a loyalty program and whether that is in fact quantifiable, and from our perspective we would go as far as to say it is not a quantifiable cost or expense or a benefit for a consumer.

In relation to the substitution of 'reasonably practicable' with 'compelling reasons', the committee worked for a considerable period of time with Attorney-General's, the Treasury department and ASIC in coming forward with a test which had a legal meaning. Legal meaning of 'reasonably practicable' is something with which the lawyers in the room—and I stress it was a legal solution—were comfortable, and we certainly felt that that gave ASIC a framework in which they were able to administer the law in a clear and effective way. It certainly gave them tests that were able to be determined should it be necessary from a judicial perspective.

Applying a layman's term to 'reasonably practicable', you would say that it may be a little bit weak. From a legal perspective, of course, it has a very different meaning. The change of imposing a 'compelling reasons' test that it would not be possible then imposes another legal meaning, that meaning being an administrative law meaning which, of course, then gives to our members an almost impossible situation, because for compelling reasons that it is not possible, that imposes on the members a test which means that, short of having a system which is not possible to be changed, every member would have to then undertake the changes that are necessary, irrespective of the cost, irrespective of the time and irrespective of the impact that that might have on that particular member's business. We would urge that the committee reconsider the concept of 'reasonably practicable' and substitute the test that we have put in our submission—that there were compelling reasons as to its being not reasonably practicable. I have dealt with the issue of common funds, and I am happy to discuss with the committee if necessary issues in relation to the specific concerns that the life industry may have in respect of that.

Ms Doyle—I thought that I would point out some evidence that was tabled, and it was from the Chant West research, which actually is AMP Custom Super, as an example. I want to deal with the fees that have been put forward. I refer to case study 1 and what Mr Chant said about

our fees. Because we are a net-of-tax provider, he grossed up the fee to make it comparable with gross-of-tax superannuation vehicles. The point that I would like to make is that the net-of-tax amount is what the customer pays, and that is why it is disclosed in that manner. It is not the grossed-up fee that the consumer pays. That is because, for tax purposes, life offices are very different vehicles from unit trust vehicles, which is essentially what a lot of other superannuation providers, on a retail basis, also provide. So that difference in tax leads to differences in the way we disclose our fees. We are a net vehicle. Therefore, the fee that is represented as the net fee is the one that the customer pays. If we were to disclose that gross-of-tax amount, we would need an additional column next to it that says what tax deduction the customer is entitled to, which would then take us back down to the net fee representing the fee that the customer pays. So it is quite circular but we would get back to disclosing a net fee.

I would also like to point out that in that table there are some investment choices that have been compared. They are somewhat misleading as well. Column 2, the adjusted amount, should have next to it a $2 fee for investment in the cash plus and a $24 fee for the balance growth. Instead of $259, the total should be $208, because the investments should be exactly the same as they are under the net scenario.

CHAIRMAN—I think you misunderstand. What was being promulgated was that the normal sort of investment that people go into would be the future directions.

Ms Doyle—That is fine. Then in that case—

CHAIRMAN—And they would have $10,000 in that. They would not have anything in the other funds.

Ms Doyle—No.

CHAIRMAN—So it is one or the other.

Ms Doyle—Yes, it is. Mr Chant made the decision on which investment choices he would use—yes?

CHAIRMAN—Yes.

Ms Doyle—So if he had picked the future directions balanced fund for our net example, instead of $181 the fee would be $232. Okay?

CHAIRMAN—Yes.

Ms Doyle—All right. That represents a $27 difference, rather than the extraordinarily large amount that he has there. So we should compare apples with apples, please, when we are looking at what investment choices are chosen. And I will put on the record that Mr Chant chose which investment options he would like to represent us at; we did not make that decision. He may have easily chosen future directions balanced as his case study. We did not make a decision in this. I am quite confused as to why he has made such a point of it. When an analyst does comparisons of your fees and funds and things like that, it is up to them as to which investment choices they want to represent, not us. I just make that point.

CHAIRMAN—Are you saying the fee in the second column 'net of tax' should be—

Ms Doyle—It is $232, if we use future directions.

CHAIRMAN—Yes.

Ms Doyle—That is a $27 difference. If we were to disclose the gross amount, you would also have to disclose the tax deduction that that person is entitled to, which would bring us back to $232.

CHAIRMAN—Yes, I understand that.

Ms Doyle—So we need to be clear that the fee that we disclose is the fee that the customer pays as well. Grossing-up is just not an easy solution to it. Thank you.

Senator CONROY—I want to quote something, particularly given some of the evidence you have tendered about the impossibility of providing some information. It says:

> I am concerned that our industry will be seen to have created a supply driven monster that is out of control. The monster has too many product features, too many different types of fees, and too little effective disclosure. I marvel at how the average politician regulator or consumer can get their head around our various products and services. It is any wonder that we are under constant criticism. The industry needs to focus on simplifying its offerings. If it is not possible to quantify a fee in a product disclosure statement or financial services guide, we should consider banning that fee.

Yet you are telling me there are extensive fees that it is impossible to disclose.

Ms Ferguson—Where did you get the quote from, Senator?

Senator CONROY—From Doug McTaggart, the Chairman of IFSA.

Mr French—I think the chairman, in making that comment, bearing in mind the audience he was addressing, was saying that there is no room for complacency: 'You guys wake up; we have really got to move to perform better right across the board in terms of disclosure and our offerings.' That is what he was saying. He is trying to drive some change there. There is always some complacency in industries and that is all it is—it is just trying to make people lift their game a bit. That has always characterised this industry. It is a very competitive industry.

Ms Ferguson—It is not a matter of complacency, either. There are two components to it. The first thing is that the current systems that many of these products administered are on just do not allow for change. There is a strong technological component. It is also wrapped into the whole product rationalisation debate, of which you are aware, that IFSA is driving that. Until such time as there is adequate legislative reform to permit product rationalisation to go forward there will not be the change that will allow us to simplify our products and certainly our systems.

I think that the debate has already been opened. IFSA has already had a forum to which a number of participants came, including Treasury, ASIC, Attorney-General's and various industry groups. There has been an agreement to go forward and consider the whole issue of product rationalisation, but that underpins the fact that we are striving to improve investor disclosure. As

an industry we believe that it is an appropriate thing but it has to be done within the frameworks that we have and, for some members, it is going to be a very difficult road to go down.

Senator CONROY—I guess we stand admonished.

Ms Ferguson—Thank you.

Senator CONROY—I want to return to the last part of the statement. He said:

If it is not possible to quantify a fee in a product disclosure statement or financial services guide we should consider banning that fee.

You are suggesting to me there are many fees that just can't be quantified.

Ms Ferguson—I do not think I said there are very many fees that can't be quantified.

Mr French—We are not saying they can't be quantified.

Senator CONROY—You just do not want to disclose them.

Ms Ferguson—No, that is not true.

Mr French—The FSR amendments that are now in the Corporations Act require us to disclose them and the ASIC fee table sets out how and unbundles those fees. There is no way you can get away without disclosing them now.

Senator CONROY—So entry and exit fees can be quantified?

Ms Doyle—Yes.

Ms Ferguson—In the PDS—

Senator CONROY—That was my misunderstanding—they could be quantified. I am trying to understand why they should not be included in a single bottom-line figure.

Mr French—That is a very different thing to do, though, isn't it—to then roll them up, regardless of how they are calculated, into one number on the basis of a whole lot of assumptions. Could I direct that question to Ms Rubensztein, who has prepared a detailed presentation on the single fee measure and is able to answer it in a lot more detail than I am by virtue of her expertise in the area.

Ms Rubinsztein—If you don't mind, I will just go through this presentation briefly. It basically summarises our position on the single fee measure. We have to be clear about what our objectives are and what we are trying to achieve. We think similarly to other people but we want people, firstly, to be able to understand the amount of fees that they pay and, secondly, to be able to compare different products. So there are two clear objectives.

Senator CONROY—I would have thought that the principal objective is for consumers to have revealed to them the total cost to them. They are not quite the same things as the two objectives you stated. I think you have a flawed premise and I think your objectives are flawed.

Ms Rubinsztein—To my way of thinking, that first one does cover exactly what—

Senator CONROY—If we are lucky, it might.

Ms Rubinsztein—No. I know we have heard other submissions that have discussions on what is a cost and what is a fee, but when I have written that statement, that is exactly what I mean: the total cost to the investor.

Senator CONROY—Okay.

Ms Rubinsztein—As a bit of background, a few things need to be said. We do need an outcome that meets both objectives, so a single-fee measure should meet both of those objectives. For a single-fee measure to be relevant and to be effective, it needs to apply to the majority of investors or members in that fund. I will come back to the next points there, but we need to think about this single-fee measure in the context of the other disclosure that those members are receiving. As Philip said earlier, we are already implementing a single-fee measure regime within the retail industry.

Just to summarise IFSA's position, we are very much committed to full disclosure and transparency, and we have done a lot of work, particularly with ASIC, to get us there, and we know that there is a lot of work still to be done. We support a single-fee measure. We support disclosure in both dollar terms and percentages. We do not support the use of projections, and I will go into the reasons why. Just to come to your point, Senator Conroy, we do not support trying to bundle together both up-front fees and ongoing fees, and one reason was given by Ramsay, in that the up-front fee can be dialled down, but there are another couple of very good reasons why it is problematic.

One is the mathematical reason around it, so you cannot meaningfully, from a mathematical point of view, put your ongoing fee together with your up-front fee. When you put them together, you often get a nonsense number. Coming back to the principle that, if we are going to have a single-fee measure, let us have one that applies to the majority of investors, when you put the two numbers together you often do not get a meaningful number. The second key reason is because that the up-front fee invariably relates to advice. So the up-front fee is paid for a financial adviser.

What we are trying to do here is put together the amount that is paid for a financial adviser with the product cost and put that into one fee, which is clearly going to inflate the fees in our retail products relative to industry funds or corporate funds in a way that we think is unfair because you are not comparing apples with apples. In one situation somebody gets financial advice and in another situation one doesn't. I will come back to that. So what we propose is this: in a PDS what should be shown is a separate disclosure of the up-front fee and the ongoing fee. Consumers need to compare both. They need to say, 'What is the up-front fee and what is the ongoing fee?' We would like to see the OGFM trialled in the marketplace.

I would like to draw your attention to this graph because I think, of everything that I have heard today, this is where the biggest misinformation is being discussed. It is the level of up-front fees. The product provider does not keep the up-front fee; it is paid on to the financial adviser for the financial advice. This is some data out of a recent Assirt adviser trends report, talking about the average up-front fee that is actually paid. As you can see from the graph, the average is about 2.2 per cent. So that is why we are all sitting here to some extent. A lot of the models that have suggested including the maximum up-front fee allowed in the PDS, so four to five per cent, again unfairly make our products look incredibly expensive. Not only is it there to provide for advice but, typically on average the fee is not four to five per cent, it is about 2.2 per cent. In addition to that, with our flagship product, FirstChoice, the experience that we have had over the last year is that the up-front fee has been in the range of about one per cent.

I will skip over the next one but I thought it was worth mentioning the level of ongoing fees. There is broad agreement in terms of what people think the ongoing fees are. There have been two reputable studies, and broadly they say the same things. But just for the record, an industry fund will charge, as an ongoing fee, between one per cent and 1½ per cent, depending on whether it is small or large, and a retail product is more in the region of about 2.13 per cent.

This next slide sets out why we have such problems with projections, but there two important points there. The first is that we have been down the projections road before. We have had it in legislation—the life act—and it was discontinued for a very good reason. Consumers invariably misunderstand projections. They view them as a benefit promise. Whatever you do in terms of disclaimers, that is what they see, and it becomes misleading. I will not go into the other reasons, but there are other compelling reasons related to projections.

Then the next two slides go into our concerns with two of the current models, being the AFSA projections approach and the Chant West model. I am not going to go into detail on those—I can if you want—but suffice to say that the projections issue is fraught with danger and that anything that tries to put together an upfront fee and an ongoing fee into one measure is not going to be helpful to the majority of investors. It is a mathematical problem to try and put those together. You are going to have to make assumptions, which means that it is misleading to a lot of the investors who are using it.

There is a slide on what our preferred approach is, just showing for illustrative purposes how we very much embrace disclosure but we want disclosure of upfront fees separate from ongoing fees. We think it is necessary to put it in percentage terms and dollar terms, and we think that this approach is the approach that best meets those initial objectives of people being clear on the total cost or fees that they are paying, as well as being able to compare them between products.

Finally, I reiterate the point that we have done a lot of work in the past in trying to improve our game. We know that we have to respond to consumers on this, and we are very committed to trying to continue to improve. We are also committed to trying to work with AFSA to come up with a single-fee measure that we are all in agreement on.

CHAIRMAN—Thanks, Ms Rubinsztein.

Senator CONROY—Can I be a fly on the wall in those discussions? AFSA say they are not prepared to countenance anything without entry and exit fees, and you say you are absolutely not

prepared to countenance anything with entry and exit fees. That seems to be a pretty tough one to get around.

Mr French—It is putting both sides very strongly, and the two boards are committed to continue to discuss. These are greater minds than mine and I would not care to predict where they might end up. I think that is putting the two sides a little too strongly at present. They should be given a little bit of time on that. As for those two positions, I would hope that neither of them are totally immovable. Our reasons for stating that position in relation to assumptions and projections are pretty sound reasons, both on the basis of historical experience and logic as concluded—I think almost reluctantly concluded by Professor Ramsay—and evidenced by the fact that no other jurisdiction that I am aware of that has such a model. They are all basically MER based with separate disclosure of up-front.

CHAIRMAN—Your preferred approach is to separate out the up-front fees from the ongoing fees, according to what you have said and what you have shown here. So you would agree with some of our earlier witnesses that in fact you should break up the fees? One of our witnesses said that they should be broken up into three groups: the advice, the management fee and the administration fee. Would you agree with that approach?

Mr French—Yes.

Senator CONROY—Are you aware of an IOSCO paper released in February 2004? I mentioned it earlier.

Mr French—No, I am not aware of it.

Senator CONROY—It was only released in the last few days. It says that the disclosure of fee information should be aimed at enabling investors to understand the impact of fees and expenses on the performance of the fund. I guess you would argue that that is what you are committed to doing. The IOSCO paper also recommends the disclosure of a total expense ratio. Is that consistent or inconsistent with your view?

Ms Rubinsztein—That would be inconsistent with our view because that would try to lump together the payment for advice with the ongoing fees.

Ms Doyle—The problem with total expense ratios, or TERs, is that you just get an average for every customer within the fund. Once again, we are trying to get down to what is more representative for individuals within our funds. Ours is quite detailed in that way. TER is basically the total costs of the fund divided by the membership—it is an average for everyone. So it is quite a blunt tool.

Mr French—The TER in the IOSCO model—and I have not seen it—may refer to ongoing expenses. Maybe it does not include the advice—

Senator CONROY—I appreciate that you have not seen it, so it is hard to comment on it.

Mr French—Yes, it is hard to comment on the model.

Senator CONROY—You mentioned that you have an existing calculation that is industry practice. Has it ever been consumer tested?

Mr French—It is being consumer tested as we speak.

Senator CONROY—I was under the impression that it had been your practice for a considerable period of time.

Mr French—The new ongoing fee measure was adopted as an IFSA standard some weeks ago and now is required to go in our members' PDSs. It is reflected in the ASIC fee table in the PDS.

Senator CONROY—So you have required it to go in before you have consumer tested it?

Mr French—Yes, the ongoing fee measure is a measure. If people do not like it, that does not change the fact that we need that measure.

Senator CONROY—It is not an issue of whether people do not like it; it is an issue of whether it makes any sense to the customer.

Mr French—It is a measure that is needed. The only consumer testing we have done is that we have tested the ASIC fee template in a model document. Like all the other consumer testing that has been done, it was done on a small sample of people—fewer than 20 people. That is consistent with other people's testing as well.

Senator CONROY—But ISFA and the Consumers Association have tested the ASIC model and it is, frankly, a disaster in terms of understanding.

Mr French—We did not set out to test the ASIC fee template; we set out to test the whole PDS. By the by, the PDS performed well in some areas and poorly in others but, to our delight, the part of the PDS that came out best in the consumer testing was the ASIC fee template. That came up with a really high score. People were able to understand the unbundled fees—what it added up to and what they were paying for. But we will be doing further consumer testing of actual documents in the marketplace with the fee template and with the ongoing fee measure.

Senator CONROY—It terrifies me that, on a relative basis, it came up best. That just tells me how badly the rest of it must have gone, given that everybody else who has ever tested it has said that the ASIC fee model is a disaster.

Mr French—Like the other testing, it was such a small sample that we have not published the results. Publishing the results of testing 10 or 20 people is risking gilding the lily a bit.

Senator CONROY—I am not asking you to.

Ms Wells—I do not think it is absolute disaster. I think the testing has shown that there could be some improvements in terms of one or two tables.

Senator CONROY—The words 'gilding the lily' occur to me at this point.

Ms Wells—It is not fair to say that.

Mr French—Senator, I would like to ask you a question, if I may. Are you aware of the size of the sample that has been used in consumer testing by other bodies?

Senator CONROY—I got the impression that six or seven different groups have been tested. Unless they are individuals, that would imply that more than six or seven people have been tested.

Mr French—They are very small samples. Statistically, you are talking—

Senator CONROY—I am sure they would welcome you providing funding for them to test more, Mr French, which would put your money where your mouth was.

Mr French—We do do our own testing to test comprehensibility of the documents, but I still come back to the point that, even if they have difficulty with the way we set out the PDS, that does not render the measure invalid. The measure has to measure something that is actually occurring and there is no getting away from that. I might not like the fact that that is six inches, but six inches it is. There is no way around that. We have to have a measure.

Ms Rubinsztein—The progress that has been made with that ASIC fee table is really significant and I do not think it should be sneezed at. For us all to get our fees into one table and to have common terminology so that investors can now compare different products and see the same fees is an immense achievement and we have put a lot of work into that.

Senator CONROY—It is just a pity consumers cannot understand it—for that immense achievement.

Ms Rubinsztein—The consumer testing showed that we needed to do more work on it. That is fine. We did not think it was going to be perfect first time.

Senator CONROY—But you have already promulgated it as your standard without testing it, firstly. Secondly, it is based on a model which testing has shown is less than satisfactory—and I am being polite.

Ms Rubinsztein—I think the logic there is not quite correct. The IFSA standard says that we need to disclose an ASIC fee table, but the ASIC fee table is still being finalised; there is a next iteration that is going to come. We will, when we roll our PDSs, incorporate the new version, which will be the new, updated one, based on the consumer research.

Mr Drummer—I think we are on a journey and certainly our industry has had a wake-up call with many things.

Senator CONROY—It is a long, long tiring journey.

Mr Drummer—It is a long journey and certainly we have had some wake-up calls along that journey. We have travelled that path together, I know. We support the FSRA—I know Ian Johnston is here today—and the basic tenets of disclosure and competency and increased

training. Part of this journey has included the ASIC fee template. The ASIC fee template involved enormous stakeholder consultation, including IFSA, ASFA, ACA, IFF, AIST, CSA, the Institute of Actuaries, the Australian Investors Association, the Australian Friendly Societies Association—

Senator CONROY—And apparently three consumers.

Mr Drummer—The ACA and many consumers were involved. I think we need to just take this next step. We have got the FSRA starting next week at the end of the transition period. We have a template in place and we can work now implementing that—as the industry has, at great cost. We can work together then with ASFA and the other bodies to improve on that over the next few months.

Ms Ferguson—The Financial Services Reform Act requires that, when we issue a product disclosure statement, it is clear, concise and effective. That is a positive obligation on every product issuer. As part of that disclosure obligation, ASIC also requires us, under policy statement 168, to look at the processes that we have to undergo in terms of good disclosure—what is good disclosure to consumers. Colonial First State, as an example, was the first into the product disclosure regime and we issued the first PDSs, as we understood it, in the market. We have refined that PDS as a result of consumer testing, with real consumers and with real people that we brought in for focus groups to discuss the way that we disclosed our information. Our next iteration of our product disclosure statement will be different and it will have different disclosure because we are taking into account what consumers are saying.

The first time that we put in the ASIC fee template will be in our next roll of FirstChoice. That product will then be again tested. So the consumer testing going forward will not be a tiny sample of people but the real investors who are investing in our product. They ring us, they email us, they talk to their advisers and they send us letters. They tell us about our PDSs. We invite them to tell us whether our PDSs are working and we invite them to discuss with us disclosure and we take on board their views and we translate that into improvements in our documents and our disclosure. We are passionate about disclosing to our investors the things that they want to know. We are talking about real-time consumer testing, not some spurious sample, not some people who do not necessarily invest in our products. We are talking about the very people who are investing in our products—the over 600,000 ordinary Australians who invest in Colonial First State products. Each and every one of them has the ability to contribute to the refining of our product disclosure.

So when the ASIC fee template is out there they will be looking at it and examining it and they will be telling us, very strongly, what they think about it because we have always invited them to contribute to us their thoughts about it. So, yes, there has been some consumer testing; yes, the samples may have been small, but going forward the samples that our industry is going to be putting out to the market are huge. I can only see that that is going to cause a greater refining of that ASIC fee template, of course in consultation with ASIC.

Senator CONROY—I just reiterate how much a fan I am of Mr McTaggart where he says that if it is not possible to quantify a fee in a product disclosure statement of a financial services guide we should consider banning that fee. I admire your optimism, Ms Ferguson, but to me a

sale is consumer testing. We are unfortunately pressed for time, and I am in danger of drawing the wrath of the chair by going on, but thank you all.

Mr French—I thank all members of the committee and the secretariat for compressing the proceedings to give us a chance to come on a bit earlier. After a long day it is much appreciated.

[7.06 p.m.]

LAWLER, Mr Luke, Senior Adviser, Policy and Public Affairs, Credit Union Services Corporation

VENGA, Mr Raj Ashwinn, Director, Policy and Regulatory Affairs, Australian Association of Permanent Building Societies

CHAIRMAN—Welcome, Mr Lawler and Mr Venga. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to respond in private, you may request that of the committee and we would consider such a request to move into camera. We have before us your written submissions, which we have numbered 2 and 6. Are there any alterations or additions you wish to make to the written submissions?

Mr Lawler—No.

Mr Venga—No.

CHAIRMAN—I now invite you to make an opening statement.

Mr Lawler—The main issue that has everyone's attention here today is the dollar amounts disclosure. We support dollar amounts disclosure where it clearly benefits consumers. In deposit taking, dollar amounts disclosure is generally what happens now without any regulatory or legislative coercion to make that happen. If there are fees associated with deposit products they are disclosed in dollar amounts now, generally speaking. Our submission cites some examples where dollar amounts disclosure would be either impossible or not justified in terms of consumer benefit. The debate on dollar amounts disclosure is focused on complex products, like superannuation and managed funds. For example, we note that the Consumer Association's submission to this inquiry talks about super and managed funds—it does not talk about deposit products. However, deposit taking is now caught in the crossfire, if you like, and providers of simple, well-understood deposit products are faced with an unexpected new compliance burden.

The first compliance issue is how ASIC will decide what is not possible to disclose as dollar amounts, by what procedure or instrument this will be achieved. We just do not know, and the commencement date for the requirement is less than four months away. Secondly, the dollar amounts requirement in the current draft regulation does not recognise that in some cases, though it may be technically possible to disclose in dollar amounts, to do so would be costly, and even pointless, and in some cases misleading. For example, in the case of the so-called termination value of term deposits withdrawn before the term ends, expressing that item as a dollar amount would in fact be irrelevant to most depositors and misleading to many, and it would require elaborate systems changes. That would mean a diversion of resources from other priorities that would actually benefit credit union members. A solution we put forward to the problem that the dollar amounts requirement poses for credit unions is to remove deposits entirely from the dollar amounts requirement, or at least remove the requirement from the periodic statement provisions.

CHAIRMAN—Have you raised this with Treasury or ASIC as an option?

Mr Lawler—We have raised it with ASIC, but ASIC, as we understand it, are awaiting the finalisation of the regulation before they can respond. We have provided to Treasury similar advice to that we have provided to this committee, and I guess we wait for the outcome of the Treasury's consideration and the committee's deliberations.

Senator WONG—I did not catch you answer. You have raised this with Treasury and with ASIC?

Mr Lawler—We have put to Treasury the same scoping of the problem that we put to the committee. At this stage we have not—

Senator WONG—What about ASIC?

Mr Lawler—We have spoken about this. With ASIC, they have a draft regulation in front of them and they are unable to come back and give us a response on the basis of the draft regulation. They are waiting until they get a final regulation before they can, for example, describe what process they would have to assess what is or is not possible.

Senator WONG—So the exclusion that you are recommending would be fairly narrowly cast, would it?

Mr Lawler—Excluding deposits.

Senator WONG—Which deposit products are in 7.6.04A?

Mr Lawler—All deposit products issued by an authorised deposit taking institution would be.

Senator WONG—Do you think it is reasonable for that kind of exemption to be sought?

Mr Lawler—It would immediately solve the problem. It seems to us—

Senator WONG—I understand that, but there are other public policy considerations. I can see what you are saying in terms of some of the examples you have given, but do you need that kind of exemption to deal with the actual practical difficulties you are describing, or could it be more narrowly cast?

Mr Lawler—It could be more narrowly cast. I guess an overarching point we are making is the debate about dollar disclosure is very much a debate about super and managed funds and complex products. No-one is coming forward saying there is a public policy issue with deposits in terms of the disclosure.

Senator WONG—But if there is a general principle around disclosure, how would you suggest your exemption could be more narrowly crafted to deal with the practical difficulties you have indicated?

Mr Lawler—The specific practical difficulty of having to disclose a dollar disclosure for the termination value in a periodic statement we contend would, in fact, not provide a benefit at all to consumers. You could put in a specific exemption and regulation to cover that particular provision.

Senator WONG—Or an alternative disclosure. What would be more appropriate information to disclose there instead of termination value?

Mr Lawler—You would describe how you arrive at a termination value, and you would arrive at a termination value for early withdrawal of a term deposit. The sort of information that is provided now, which is usually an interest penalty of some kind, or possibly a fee and an interest fee penalty, you would continue to disclose that. You would continue to provide information about a termination value but you would not have the requirement to put in a dollar amount. The problem with the dollar amount is that it is difficult to do and it does not help consumers. It may in fact mislead consumers because people would be getting information about an event which is past, but they did not withdraw the funds. Most people with funds in a term deposit are not withdrawing the funds. If they did withdraw the funds, they would know what the termination value was. It just does not make sense to have to disclose that as a dollar amount, because you are getting a periodic statement. It is looking back. They would be getting a periodic statement which tells them what they would get had they exercised their right to get out of their term deposit early. In fact, most people are not getting out of their term deposit early—

Senator WONG—They obviously did not because they got—

Mr Lawler—And they haven't—

Senator WONG—Or if they did get it—

Mr Venga—It is also very misleading, and we are concerned because—and I think CUSCAL has the same problem—a number of our customers are elderly people and for them to see a second figure there, which is different from a closing balance, would be a cause of alarm. My own experience is that I have had a couple of elderly people call me up and say, 'There appears to be an adjustment in my statement; I want a new statement without the adjustment so that it looks the same as the last one I had.' They get very, very worried when they see something different.

Senator WONG—I understand that. You do not have a difficulty with it being prospective; your concern is retrospective—

Mr Venga—That is right.

Mr Lawler—We have absolutely no problem with disclosure of a dollar amount—for example, a fee. If you withdraw your term deposit early, there is a fee. We have no problem with that whatsoever. The problem is in saying that this is the amount of money that you would be withdrawing out, taking into account possibly an interest penalty or possibly a fee—or possibly both.

Mr Venga—It is a hypothetical amount which we think is not just meaningless but also detrimental to our customers. Another option, if you do not want a specific carve-up for deposit products, is perhaps for the regulations to define termination value for deposit products only as the closing balance, and that might solve our problem. I think we would not object to that.

Going one step further, the other issue we have is the definition of significant benefits. There is not much of a definition which we can work with. In terms of deposit products, we have mentioned a couple of examples of significant benefits, and these cannot be quantified in monetary funds. To be compelled to put things in dollar terms would immediately put us in default of the legislation. Obviously, our products are very narrow, and we do not have the same problems that the funds have. We thought a possible solution for us, and only us, is that if it is impossible to undertake something in dollar terms and there are no alternatives—for example, you cannot put in the alternative of a percentage—then we should acknowledge that and examine those kinds of disclosures.

Senator WONG—What are the sorts of significant benefits that one cannot quantify? What are you talking about?

Mr Venga—As I said, because it is not defined, we would cover something like the payment of interest on a periodic basis instead of at maturity. It is the possibility that interest rates—

Senator WONG—What is difficult about quantifying that?

Mr Venga—How do you quantify the fact that the person has the benefit of being paid interest on a monthly basis as opposed to at maturity? You cannot put a figure on that—it is a benefit in itself. It is not the amount we are talking about; it is a convenience. Elderly people may want monthly payments, for example.

The other interesting point is the fact that interest rates may decrease at a rate below the fixed rate, and your benefit of course is that you will still be getting the higher rate. It is pure speculation as to how you might put this into dollar terms. We are not trying to get out of any obligations; we want something that is workable. We do not want to be seen as not doing the right thing, because we are very supportive of dollar disclosure. I think anything that is good for consumers is generally good for us.

Senator WONG—Generally.

Mr Venga—There are instances, and these are the instances where—

Senator WONG—If they know what they are paying in fees and charges, your members can compete reasonably well.

Mr Venga—As I said, we do not have a huge range of fees and charges. We are very straightforward.

Senator WONG—That is what I am saying.

Mr Venga—So we are not worried about it.

Senator WONG—Thank you.

CHAIRMAN—Your concern is that the 'compelling reason' and 'not possible' tests may not apply to you in these circumstances?

Mr Venga—The concern is that, if we have to go to ASIC each time to make a case, it just will not work. I say that if something is impossible, because you cannot quantify it in monetary terms, let us acknowledge it and exempt it.

Senator WONG—Isn't it the case, though, that ASIC could make a determination under the regulations in respect of a class of deposit products? You are not suggesting, are you, that the terms of the regulations would require every one of your members in relation to every deposit product—

Mr Venga—I am hoping not.

Senator WONG—We are here looking at the terms of the draft regulation. I would have thought that there were some pretty reasonable arguments in what you were putting to us. Surely the text of the current regulations will deal with this.

Mr Venga—Well, there is a view—one legal interpretation is that generally ASIC would, just on the literal interpretation, have to sign off, as it were, on these kind of PDS. For example, if your PDS—

Senator WONG—There is an out.

Mr Venga—What is the 'out'?

Senator WONG—The 'out' is the compelling reason. If ASIC determines that for a compelling reason it is not possible to state the amount in dollar terms. Sorry, that is actually not it, but words to that effect.

Mr Venga—I appreciate what you are saying. To put a case and to go through this whole rigmarole for something that is obviously quite impossible, it does not make any sense. It seems to be bureaucracy gone mad, I would have thought, and ASIC does not have the resources to go through each of these cases.

Senator WONG—You are arguing against a strong person here. What I am putting to you is: wouldn't the regulations in their current form enable ASIC to make some sort of determination in respect of a class of products? Is your legal advice about that?

Mr Venga—It talks about 'possibility', so if it is possible it can be done. We are saying some things are impossible—

Senator WONG—Yes, that is a pretty compelling reason, Mr Venga, I would have thought.

Mr Venga—Other things are possible, technically, but at what cost? One of the examples Luke and I raised was the issue of periodic statements where in fact you have to set out the

termination value. How do we go about doing that? I do not know. I have not seen anything from ASIC that would indicate how to sort that out.

Mr Lawler—Certainly if ASIC had an approach where they could promptly make judgments, promptly issue some sort of class order or statement about these things as simply out, it is accepted that this is not possible, sure, that would work, but we just do not know that. At this stage we are closing in on the commencement date for the requirement. You are proposing that it could work, and hopefully it could work but we just do not really know that, so I guess we are raising that it is an issue and someone is going to have to make those judgments. We are not quite sure on what basis or how the decisions are communicated or what the actual process is. That is one part of the point we make, and the second point is that there are actually some situations where it may be possible technically.

Senator WONG—So you do not think it is necessary?

Mr Lawler—It just does not really make sense. There are not that many, I should say, but there is one in particular which sort of leaps out. There may be others and it just seems that if it is that tough a test then it could create more unforseen difficulties down the road.

Senator WONG—Could I encourage you, Mr Lawler and Mr Venga, to bear in mind that our job is to look at these regulations, and there is obviously a range of different views in the sector but there are obviously concerns about widening a definition that there has already been a lot of argument over. If you have anything additional you want to say regarding specific areas of cover that you say should occur, bearing in mind that there are those of us in this committee who have a view that cover should be minimised, we would appreciate that information.

Mr Lawler—I appreciate that.

CHAIRMAN—I thank both of you for your appearance before the committee. It certainly helped with our deliberations.

[7.24 p.m.]

DRUMMOND, Mr Robert, General Manager, Insurance Council of Australia Ltd

KIMBER, Ms Sarah, Member, Insurance Council of Australia; and Manager, Compliance Risk Management and Corporate Affairs, American Home Assurance Company

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee and we would consider a request to move in camera. We have before us your written submission, which we have numbered 3. Are there any alterations or additions you wish to make to the written submission?

Mr Drummond—No.

CHAIRMAN—I invite you to make an opening statement or statements, at the conclusion of which we will proceed to questions.

Mr Drummond—Thank you. I will keep our opening remarks very brief and simply highlight at this stage the two issues which form the subject of ICA's submission to the committee. The first falls within regulation batch 6 and relates to the proposed new regulation 7.7.02(5)(a), which covers advertising disclosure. The general effect of this subregulation is to provide a limited relief or exemption from providing a general advice warning at an FSG when financial service providers advertise in the media or on billboards to the general public.

The explanatory note recognises the practical difficulties of providing general advice and information, particularly over the radio, with the extra broadcast time and extra cost which this involves. However, ICA believes that the relief provided by the proposed subregulation does not go far enough in practical terms, in that advertisers are still required and obliged to meet the requirements of section 101(8)(a) of the act. Section 101(8)(a) is intended to catch all financial product advertisements—that is, those which advertise products for retail customers. It would still require general insurers to provide information in a radio advertisement that a PDS is available and about where it can be obtained, as well as an indication that the person should consider the PDS in deciding whether to acquire the product. In other words, the very practical concerns about extra broadcast time and cost recognised in the explanatory notes would not be addressed in the subregulation.

Our submission comments on some of the costs of complying with this section and its potential impact on the use of radio advertising by our member companies. Many ICA members make very extensive use of radio advertising, and the principal purpose of advertising is to attract inquiries through other means. So the need to add comments about the availability and the need to read PDSs in perhaps a 30-second advertisement could take up 15 seconds of the advertisement. We just do not believe that the relief goes far enough.

CHAIRMAN—Thank you, Mr Drummond. Do you have anything to add, Ms Kimber?

Ms Kimber—No, I do not, thank you.

CHAIRMAN—This is an issue that I took up with the minister some time ago, and I think it was as a result of that that the change was made. But you are saying it is not going far enough. I would have thought that a very brief statement would now suffice. My recollection is that it was Ian Berry Insurance who approached me on the issue. I would have thought that a statement—along the lines of: 'Obtain your PDS from Ian Berry Insurance'—at the end of the thing would have been adequate. You do not believe that would be the case?

Mr Drummond—Our members are concerned that the requirements of Section 101(8)(a) still effectively require a threefold statement: that there is a PDS available, details of where people can get it and a caution that they should read it before making their decision about the product. If you are advertising over several dozen radio stations, giving information about where the PDS can be obtained is just not practical. It is not a simple statement. Our members have timed this thing and it could take up to 15 seconds or longer.

CHAIRMAN—I know that the length of time presented to me was what the original draft said would be required.

Mr Drummond—Members believe that the concerns still remain and the subregulation does not go far enough.

Ms Kimber—Just to add to that, if an insurance company has a number of multiple distribution channels it is very difficult on a radio advertisement to clearly specify where you may obtain a PDS, especially when there is more than one branch, more than one office or more than one channel being used in distributing the documentation.

CHAIRMAN—It seemed to me that it was unnecessary, because to purchase the product you are going to have to make contact with an agent or a broker and discuss the product, and at that stage they are going to have to give you the PDS in any case, aren't they?

Mr Drummond—That is right—within a very short time, and like all general products there will be a 21-day cooling-off period. So all of the safeguards are available to the customer and spelling out that caution in the radio advertisement just seems to be an unnecessary imposition.

CHAIRMAN—I certainly agree with you.

Senator WONG—Is it your position, though, that you simply do not think it is necessary for your members to have to give this caution—or whatever one might call it? I notice in your submission that you say:

> ... even if broadcast time was not extended and current advertisement content was modified to incorporate Section 1018A disclosure, there is a significant 'opportunity cost' borne by the advertiser in terms of dilution of marketing impact.

Is that actually your position—you do not want to have to disclose it at all? So even if we tried to make it more simple, your position would still be, 'No, we don't want to have to do it.'

Mr Drummond—We think it is unnecessary, because of all of the protection that follows on when the customer makes contact. I repeat the point that the purpose of the radio advertisement is to attract customer contact.

Senator WONG—Yes, and they may form an impression about what your product is as a result of the advertisement. Don't you think it is appropriate they also be told that they are entitled to have this document that they can look at in order to better inform themselves?

Mr Drummond—Possibly that, yes, but the three-stage part of the statement—

Senator WONG—The part that says that there is one and where they can get it? Is that what you call the three-stage part?

Mr Drummond—Yes. The three elements of the statement would be: a PDS is available; from where it is available; and this caution or advice to read it before—

Senator WONG—And you do not think people should be cautioned to read it? They are getting this marketing message. What is the problem with them being cautioned to read the fine text?

Mr Drummond—But all of that will follow when they make contact with the advertiser.

Senator WONG—I understand that, but I suppose it is a question of impressions. Ms Kimber, when you said, 'We have multiple agencies,' is it your understanding that under the act you actually have to give the address?

Ms Kimber—No, but where we are talking about multiple distribution channels it is difficult to specify to a consumer where the PDS is in a radio advertisement.

Senator WONG—Ian Berry Insurance or your broker, I suppose.

Ms Kimber—Sorry?

Senator WONG—Go on.

Ms Kimber—Sorry, I did not hear that.

CHAIRMAN—Senator Wong was saying, 'Ian Berry Insurance or your broker.'

Ms Kimber—It is possible but, again, is that necessary in terms of advertising time and the cost involved in adding extra words to that effect on to a radio advertisement?

Mr Drummond—Bear in mind that the average radio advertisement runs for only about 30 seconds. Our members have timed this, and it could take up half of a 30-second advertisement.

Senator WONG—But that is not your position, though. Your position is not that it takes up too much time; your position is that you do not want to do it at all.

Mr Drummond—Both.

Senator WONG—Even if it were shortened, your submission says to us, 'We don't want to do it because it dilutes marketing impact.' I am saying that perhaps that is the policy issue, the policy objective—that people should not just be sucked in by smart advertising. Do you disagree?

Ms Kimber—I think if consumers were not provided with the documentation upon contacting an insurer or intermediary, that might be an issue, but where the advertising is being provided and they do need to make contact and the documentation is provided at that point—and the consumer is advised to read the documentation—it does seem to be an additional overlay of advising them that a PDS is available and from where they can obtain it.

Senator CONROY—Presumably, with a TV ad or even a billboard ad you can have a little disclaimer on it. The real issue is a radio ad.

Mr Drummond—It is the radio ad, where you cannot superimpose anything.

Senator CONROY—No, obviously there is no point—

Mr Drummond—May I comment on the second point in our submission? This one is found in batch 8 of the regulations and relates to the series of proposed regulations which require the disclosure of items in dollar amounts. ICA believes that, broadly and sensibly, these proposed regulations recognise that it is not always practical or realistic for a range of items to be stated in dollar amounts. But ICA's concerns relate to a common wording that appears in each of the proposed regulations. These words are:

> ... if ASIC determines that, for a compelling reason, it is not possible to state information to be disclosed ... as an amount in dollars ... the information may be set out as a description ...

We believe strongly that these words used in each of the proposed regulations create potential difficulties for general insurers and, indeed, for ASIC in the impracticality that they introduce. For example, there is no definition of the term 'compelling reason'. There is no guidance as to how ASIC should arrive at its determination or any mechanism for any review of ASIC's decisions. One would have to say that it is questionable whether ASIC has the resources to cope with the flood of applications for determinations, because it seems to us on a narrow interpretation that ASIC is going to have to make these determinations on almost a case-by-case basis.

The process would certainly involve considerable time for the regulator and for our members without, we believe, any really compelling compensatory benefit to consumers. For many policies, for example, it is just not possible to state the cost of the product in dollar amounts. It is also not possible to state the cost as a dollar amount in the PDS because the cost varies with the sum insured and other rating factors. Bear in mind that the PDS for general insurance products will very largely be a generic PDS covering a type of product. It will not be a PDS specific to an individual customer. So the ability to state these benefits or costs in dollar amounts is just not practical. The extent of the power that this gives to ASIC just seems to us to be unrealistic in terms of the protection.

Our submission proposes that the issue of what can or cannot be disclosed in dollar amounts should be left to the product issuer or the licensee to determine. ASIC already has the power to direct that any defective documents be withdrawn and rectified. We believe that ASIC's powers of surveillance and audit should be sufficient to ensure that disclosure documents observe the intent of the legislation and give the customer sufficient information to be able then to determine their choice of product.

Senator CONROY—I think there are some valid points being raised to think about.

CHAIRMAN—There are no questions on that aspect of your evidence. Senator Conroy has said that it is an issue that we will need to have a think about. The point has been very well made. Thank you both for your appearance before the committee.

Mr Drummond—Thank you.

[7.39 p.m.]

CLARK, Mr Douglas, Policy Executive, Securities and Derivatives Industry Association

HORSFIELD, Mr David, Managing Director/Chief Executive Officer, Securities and Derivatives Industry Association

CHAIRMAN—I now welcome the representatives of the Securities and Derivatives Industry Association. The committee prefers that all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to respond in private, you may request that of the committee and the committee will consider such a request to move in camera. We have before us your written submission, which we have marked as No. 4. Are there any alterations or additions you wish to make to the written submission?

Mr Horsfield—No.

CHAIRMAN—Thank you. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Mr Horsfield—Thank you for inviting the SDIA to appear before the committee today. We do not have a problem with batch 6 or batch 7, but we do have a problem with batch 8 in relation to the dollar amounts being disclosed. In our opinion, it should be a percentage rather than a dollar amount. As commission rates have been deregulated since 1981, we think it would be a backward step. In fact, by using dollar amounts, we believe it would actually prove to be unworkable. I want to now hand over to Douglas Clark, our SDIA policy executive, who will give a brief outline of our submission.

Mr Clark—Our submission, as David mentioned, concentrates on batch 8 of the three batches of draft regulations before the committee. In our written submission, we have concentrated on the issue of fee disclosure and product disclosure statements, but the issues and principles we raise could equally apply to the disclosure of commissions and fees in statements of advice and also in periodic statements, as the same language in batch 8 applies to those two instruments as well as the PDS. We are concentrating on the PDS because we are in the process of producing a template PDS for our members to use. Most of the products which stockbrokers deal in do not have to be covered by PDSs because they are securities—they are covered by things like prospectuses and continuous disclosure. The exception with our members is derivatives: where the dealer is dealing in exchange traded options, for example, a PDS must be supplied to the client. Under the new regulation 7.9.15A, dollar amounts must be used to disclose fees and commissions, unless ASIC feels that there is a compelling reason not to do so.

This scenario we are talking about now is a client who is being advised to buy some BHP September 2004 options on the exchange's derivatives market. It is a transaction for which the stockbroker earns commission. Upfront commission is paid. There is no trailing commission; there are no management fees. It is a straight out purchase of a product for a commission rate. That is the way stockbroking works, and that is the way clients are used to it working. They do not require documents upfront which tell them exactly how much in dollar terms they are going

to pay in every instance. Typically with commission rates, a minimum amount will be specified, say, $100 minimum plus 0.1 per cent of consideration, being the total price of the options that are purchased. These rates can vary from time to time. In particular instances, favoured clients may get discounts because they deal more. In order to resolve complaints, clients may be given a lower rate or no rate. Some particular advisers may be entitled to charge more rates because of their status in the firm. Normally, it is a percentage rate and it is standard across the firm.

At all times too these rates are negotiable. Having to express a negotiable rate in dollar terms upfront in a bargaining situation is also inappropriate. This is not rocket science that we are talking about; it is a percentage of a rate. If you have paid $10,000 for some options, you multiply it by 0.1 per cent and you know what commission you are paying. In the options market there will be additional fees that are charged by the exchange at a separate rate, and those are disclosed on the contract note, post the transaction, and they will be disclosed upfront in the client agreements and in the financial services guides. They too cannot be expressed in dollar terms. They will be expressed in a sliding scale of percentage rates.

Our aim in producing the template document for the industry—for clarity and certainty across the industry and for clients—is to produce a document that can be used generically, one per firm. So one firm can have one options PDS to give to all clients. In terms of being clear, concise and effective, we think that this will be sufficient for all clients, especially given the other disclosures that are made by the stockbroker—including compulsory disclosure and explanatory documents provided by the exchange which tell the client what the product is, what it is all about and what the risks are. So we cannot see any downside for the client in what we are asking. In fact the client will expect to be charged a percentage rate and see a percentage rate in all documents that come to him or her, like a PDS.

The other problem, apart from not being able to give a dollar disclosure in every PDS, will be the exception—namely, where ASIC feels that there are compelling reasons not to disclose a dollar amount. As you have already heard today, we cannot see, administratively, how ASIC is going to cope with that. In our industry there will be anywhere between 90 and 300 PDSs on issue at any given time. If every one is not in a position to make a dollar disclosure then each one will need to, effectively, be approved by ASIC.

Senator CONROY—Your argument seems to be not that it is not possible to provide this figure but that it is just not industry practice—is that a fair summation? Is it the case that there is no compelling reason that you could put to ASIC? Some of the other witnesses have made the case that it is just impossible to comply with this. You are not making that case; you are just saying that it is not industry practice, it is not what people expect and so you should not have to do it.

Mr Clark—It is true that it is industry practice to charge a percentage rate, and that is what clients expect. It is also true that it is impossible in a PDS to state up-front the dollar amount of commission that will be charged.

Senator CONROY—You have said that people pay commission up-front.

Mr Clark—They pay commission up-front on the transaction—once they buy or sell the product.

Senator CONROY—That does not sound like up-front. It is just that when you were talking about it I specifically wrote down 'up-front' because I thought you said that they pay up-front. If they pay up-front, that implies to me that they pay before the transaction takes place—and please correct me if I am wrong or if I have misunderstood you.

Mr Clark—After each transaction they pay a commission. I was trying to distinguish it from commission that is paid on an ongoing basis. I apologise for any confusion. That is industry practice, sure, but it is also impossible—until you know how much the transaction is worth—to tell the client how much commission they are going to pay.

CHAIRMAN—Until you know whether he is buying $10,000 or $100,000 worth.

Senator CONROY—Do they give you X amount of dollars and say, 'Go and buy as many as you can of whatever,' or do they say, 'Go and buy me 10,000 unit of X and then tell me what it would cost'? How does it work?

Mr Clark—In that scenario, they will be able to tell you because they will check their system and say: 'Right, this client is paying one per cent brokerage. If we buy stock worth $100,000 then he will pay $1,000 brokerage.' But a PDS is one or two steps earlier than that—that is at the start of the relationship.

Mr Horsfield—The difference is that if you start off with a PDS document and you have a fixed dollar amount and the client then decides he does not want to buy $10,000 worth but $100,000 worth then obviously the amount is going to change. Therefore, if you have one fixed rate—say, 0.1 per cent—then he knows exactly what it is going to be. The actual amount is shown on the contract note, but the rate is fixed and it goes out on the PDS document.

Senator CONROY—But by the time you make the purchase—and we are talking in real time—are we talking days or minutes? What is the real-time situation?

Mr Clark—It is a live market.

Senator CONROY—That is what I mean: it is happening almost instantly.

Mr Horsfield—The PDS goes out, the client can trade—bang!—he does it and away he goes.

Senator CONROY—But when he says, 'Buy me $10,000 worth of X' and, given it is happening in minutes or it is a live market, you should be able to tell the cost in dollar terms right then and there.

CHAIRMAN—But that is after the event.

Senator CONROY—Thanks, Grant; how about we let the witnesses argue their case?

Mr Horsfield—It also makes it a little difficult, because the spread on some of these option markets can be quite large. So on an exchange traded option, which is the American style option that can be exercised at any time, you do not really know. The spread may be two steps away from the last sale price. Therefore, your amount is then going to change enormously. If you lock

in a dollar amount, it is going to be very difficult for you; you will have to issue another PDS. If the percentage is there, it automatically rolls on.

Senator CONROY—Could it be solved by, at that point of sale, expressing the dollar cost to the consumer at that point?

Mr Horsfield—It could, but it is not normal practice.

Senator CONROY—I understand that. The FSR legislation is designed to change practices in the industry. That does include your industry as well. The whole purpose of the FSR legislation is consumer protection in the financial services industry, which, by definition, means there will almost certainly be changes—and there have been some enormous changes in some other sections of the financial services industry.

Mr Horsfield—As you know, we support all those changes.

Senator CONROY—As long as they do not apply to you.

Mr Horsfield—No, that is not right.

Senator CONROY—Right across the board.

Mr Horsfield—That is not right. We try and make it as workable as we possibly can for the client. If it is difficult for the client, the client is the person that loses out, because more time has to be taken with the client. He wants to buy the stock, he wants to have it executed and then he wants to move on. Having to turn around and be on the phone for another five minutes to work out the consideration, getting feedback from the operator and working out how much the actual amount is going to be all takes time. I was talking to someone yesterday, and he said: 'I've had so much paper piling up on my desk. I've missed speaking to 20 or 30 clients.' The client is the one that loses out. Obviously, the broker loses out as well, because he does not make any money out of it but, at the end of the day, it is the client that loses out. I understand that the FSR legislation is put in place to change a lot of things. As you know, we support that, but if it makes it more difficult for the client to do business it is therefore not good for the client and not good for the marketplace.

CHAIRMAN—Would your argument apply to purchasers of shares as much as it would to derivatives?

Mr Horsfield—Yes.

CHAIRMAN—It is done instantaneously over the telephone.

Mr Horsfield—It is the same thing. It is a live market, it is a progression. We are talking retail here, but the same thing happens in the wholesale market as well.

Mr Clark—There may be some suggestion that the client is not going to know how much commission he or she is going to be charged. There are already ASX requirements that clients sign agreements up front which specify certain matters, including brokerage rates. So it is not

going to be a surprise when they are told or they receive a confirmation—the new word for 'contract note'—which says, 'You've bought $100,000 worth of options and you are also being charged $1,000 brokerage.' That is exactly what they will be expecting. There is no mystery about that for the client.

Senator CONROY—That is why I am trying to understand what your problem is.

Mr Clark—The problem is that the PDS cannot express the commission in dollar amounts; only in percentage amounts.

CHAIRMAN—What you are saying is that you can do it retrospectively but you cannot do it in advance in dollar amounts.

Mr Clark—Correct.

Mr Horsfield—That is right.

Senator WONG—Given that, what is your concern with the current wording of the regulations? If your case is so compelling because of the nature of the transaction, which is essentially what you are talking about, why do you say that you would not, under the terms of the current regulation, be able to be granted a determination by ASIC that would enable percentage disclosure in the PDS?

Mr Clark—It is entirely dependent on ASIC agreeing with it.

Senator WONG—Have you talked to them?

Mr Clark—We are in discussion with them at the moment.

Senator WONG—Have they told you to go away?

Senator CONROY—They are pussy cats; I would not be worried!

Mr Clark—They are working on the same—

Senator CONROY—I have always found them very easy to deal with.

Senator WONG—The concern is, obviously, that we are here trying to look at the draft regulations and we have had a number of groups saying, 'We want to carve out.' You do a bit better than the Insurance Council, who seems to say there should be very little regulation and basically we should let ASIC chase it up if it is bad. At least you are one step ahead. But in relation to your concern, I am not quite clear why you say the current terms of the regulation do not give you cover.

Mr Clark—That is because if we are not expressing them in dollar amounts then we have to go to ASIC and convince them that there are compelling reasons not to disclose.

Senator WONG—Why do you think you cannot do that?

Mr Clark—We can try.

Senator CONROY—What are they saying to you now? What have ASIC said so far?

Mr Clark—We have only had informal discussions.

Senator CONROY—What are they saying? Are they not sympathetic, saying no, or 'Absolutely not'?

Mr Clark—I think there is sympathy, but I cannot speak for ASIC. They will no doubt speak for themselves later on.

Senator WONG—Mr Clark, why would we change the regulation if the current form will give you sufficient relief?

Mr Clark—It should at least give some assistance to ASIC in regard to what should be compelling reasons if, for example, it is impractical or impossible, which I think is a concept that has been used previously in the context. And it is all about being 'clear, concise and effective'. We are not saying anything that is against that principle.

CHAIRMAN—You are saying there should be a definition of compelling reasons.

Senator WONG—Is that your evidence?

Mr Clark—We would prefer to see the reference to ASIC having to have those reasons deleted from the regulation.

Senator WONG—I cannot speak for everyone else, but your argument, the evidence you have given today, simply does not support that.

Senator CONROY—The legislation says it is compelling unless ASIC say otherwise. It is legislation. The proposition you are putting forward is actually flawed, if that is your understanding, because the legislation has passed the parliament. The legislation gave the capacity to ASIC, in certain circumstances, to give relief; but your argument is to actually change the legislation, so I can tell you it is not going to happen.

Mr Clark—This is the regulation we are talking about.

Senator CONROY—The regulation is consistent with the legislation.

Mr Clark—It does expand on the legislation. The legislation does not say specifically that you have to state dollar values unless ASIC feels that there are compelling reasons not to.

Senator CONROY—It was a very messy debate on the floor. I hope you never have to read it.

Mr Clark—Thank you; I have read it.

Senator CONROY—Very messy.

Senator WONG—I am confused, Mr Clark, because it seems to me the proposition you are putting to us today, and what you are seeking from it, is a very long bow to draw. You have given evidence that it is difficult or impossible for you because of the nature of the transaction. Fair enough. You are then saying, 'We want you to take out of the regulation the requirement that ASIC have reasons.' Or did I misunderstand your evidence?

CHAIRMAN—You—

Senator WONG—Let them give their evidence.

Mr Clark—We would prefer to see the obligation for ASIC to have to have compelling reasons removed from the regulation and replaced with something that reflects the reality of the situation.

Senator WONG—The reality of the situation means the current practices in the market. We are not going to do that. If you have a proposition that actually relates to the specific issue you are raising, please put it to us, because what you are proposing to us is a removal of ASIC being required to have a compelling reason, which I think is pretty integral to the legislative test that is prescribed. Do you see what I am saying? You are saying, 'Here is this problem, and we want this massive change.'

Mr Clark—We do not think it is a massive change.

CHAIRMAN—Rather than a massive change, are you seeking a minor change to the regulation which relates specifically to your situation, which would give you certainty rather than being reliant on ASIC's determination?

Mr Clark—That is correct.

Senator CONROY—That small change, as Senator Chapman described it, guts the legislation.

Senator WONG—That is right.

Senator CONROY—I use the word 'guts' very advisedly.

Senator WONG—You lobby how you want, but what you are proposing to us is contrary to something that was pretty hard—a subject of very lengthy discussions in the Senate. What you are proposing to us is inconsistent with the provision that was arrived at in the legislation. My suggestion to you is: if you are serious about saying, 'This regulation does not deal with our specific transaction,' then perhaps you ought to put something less ambitious to us. Obviously, the evidence you give is up to you, but I do not think your evidence supports the proposition that you are making.

Mr Horsfield—All we are talking about is changing from a dollar amount to—

Senator WONG—No, Mr Horsfield, you are. Mr Clark is telling us that we should take out the test in the regulations that refers to ASIC. It is a very big jump.

Mr Clark—Clearly, we will have to seek relief from ASIC for every PDS that crosses our members' desks.

Senator WONG—No, that is not right. ASIC can make class determinations. Have you looked at that with them?

Mr Clark—We have not. We will have to consider that. We have no idea what policy ASIC will apply in considering such an application.

Senator WONG—Essentially, what you are coming to us with is: 'We don't know what ASIC will do, so can you give us some relief before they do it?'

Mr Clark—We would prefer to fix it through the regulation, rather than having to go to ASIC in every particular instance that our 69 members issue a product disclosure statement.

CHAIRMAN—As there are no further questions, Mr Horsfield and Mr Clark, thank you for appearing before the committee.

[8.03 p.m.]

CASS, Ms Debra Elaine, Chairperson, FSR and Compliance Committee, Australian Financial Markets Association

FARROW, Mr Kenton Geoffrey, Chief Executive, Australian Financial Markets Association

RAPPELL, Mr John Robert, Head of Policy and Strategy, Australian Financial Markets Association

CHAIRMAN—Welcome. The committee prefers all evidence be given in public, but if at any stage of your evidence or responses to questions you wish to respond in private you may request that of the committee and the committee would consider such a request to move into camera. We do not have a written submission from you. I invite you to make an opening statement, at the conclusion of which we will move to questions.

Mr Farrow—The Australian Financial Markets Association—AFMA—is the representative body of what we have called the interbank, or wholesale, markets of this country. There are 130 member organisations, comprising trading banks, investment banks, government authorities and the like. Our markets have traditionally always been wholesale, interbank. It is the introduction of FSR and the change in the nature of our business that has extended our domain to what could be defined under the new law as retail products.

Our customers are people who are transacting directly into a dealing room or directly with an investment bank. They are, by definition, sophisticated investors in terms of how banks treat them, although I think under law they are defined as retail customers. Therefore, a lot of the changes and instructions coming through FSR are having an impact on this sector, whereas, once upon a time, these were not part of this arrangement. The transactions we undertake as wholesale or interbank markets are what we call bilateral—they are transactions between two organisations where each party is dealing on their own behalf. Therefore, the institution doing the transaction is the owner of the risk management product or asset and they are selling that at a price under negotiation bilaterally with the counterparties they are dealing with.

One of the outcomes that has arisen from the introduction of FSR and the transactions taking place within the dealing room environments in this country is that a lot of products which were once upon a time not available to a retail customer base have become available over time. But the trend is now emerging where, through the costs of compliance and through the regulation itself, organisations are going down the path of removing access to products to this customer base. There is quite good evidence that some organisations have dropped some of their products by over a third and are discussing how they would continue to curtail that business. I do not think that outcome was intended by this legislation. For more specific information in this area, John Rappell has some comments to make.

Mr Rappell—The disclosure document regime under the FSR quite properly sets a very high standard of disclosure. Organisations and people concerned with the production and distribution

of disclosure documents are, under the existing legislation, subject to specific enforcement and offence provisions: for example, in relation to the provisions set out in part 7.9, division 9, subdivision A. They are also subject to more general liability, including liability for making a statement or disseminating information which is false or materially misleading or which may induce people to apply for financial products, particularly section 1041E. All of this is right and proper; moreover, it is widely recognised and accepted by the over-the-counter financial markets.

The OTC financial market community accepts that such a high standard should apply when dealing with retail clients, particularly in relation to disclosure of important information about financial product. However, we find it difficult to accept a standard which is impossible to meet for over-the-counter financial markets. The current batch of regulations will require, in respect of charges or pecuniary or other benefits, that all persons engaged in the preparation of disclosure documents—for example, a PDS—predict accurately whether ASIC will determine that, for a compelling reason, it is not possible to state the information in a specific dollar term. An alternative construction seems to be that it is intended that ASIC pre-vet all relevant disclosure documents, which is surely not the intention of these regulations. Secondly, those persons have to assess in advance what ASIC might consider to be a compelling reason. I have heard some evidence today about concerns about what ASIC would see as a compelling reason. Thirdly, those people have to assess whether it is, under any circumstances, possible to state the relevant information in dollar terms—in other words, whether it is possible or not.

To get any one of these three key points wrong means that your PDS or other disclosure document is subject to a recall and you may incur personal as well as corporate liability. We suggest that a reasonably practical test be inserted into the regulation that would have the advantage of being clearer for the persons charged with the production of disclosure documentation—that is, the ones subject to the offence and penalty provisions we have referred to already. The reasonably practical test should be objective; it should not be based on what ASIC thinks because of the prediction difficulties expressed in the second and third points above.

Senator CONROY—You may or not be aware that the parliament has rejected that already.

Mr Rappell—I was not aware of that. Thank you. Should I continue?

Senator CONROY—I just wanted to check to see if you knew.

Mr Rappell—Moreover, there would be no perceivable regulatory detriment in opposing a reasonably practicable test in this manner, given the existence of those penalty and offence provisions. We do not think it is a matter of simply striking a balance between consumer benefit and the efficiency objectives but rather a matter of recognising that there are existing or pre-existing superstructure offence and penalty provisions which are well known to those who need to prepare disclosure documentation and there is simply no need to impose an impossibility standard, especially one which is assessed by ASIC on the basis of compelling reasons. In place of the compelling reason trigger, we also argue that charges or pecuniary or other benefits that are simply not quantifiable in dollar terms—

Senator CONROY—What would they be?

Mr Rappell—In the over-the-counter market I think it is impossible sometimes for a provider, an issuer of a derivative product, to understand in any kind of dollar terms or percentage terms or any kind of complete manner what the benefit derived by the client would be, because by and large these are risk management products as opposed to investment products. Unless you have a complete understanding—

Senator CONROY—I find that a very frightening statement—that people do not have a clue what benefits are accruing.

Mr Rappell—I understand that you would find it frightening, but it is not about the issue of whether they have a clue or not—they have quite a good clue about this—it is about whether they can—

Senator CONROY—Someone should have a clue. Someone should be able to define a benefit or a cost.

Mr Rappell—They can define a benefit or a cost. As to whether it can be defined specifically in a dollar term is the issue. Our understanding of the interpretation of this at the current time is that we have to state the dollar benefit, not a range of dollar benefits—not an example, but the dollar benefit. A key example is a membership we have already where somebody has been under enforcement for ASIC for not stating it specifically in dollar terms. One of the issues that we would like to raise is to say, 'Yes, we understand. It is going to be between this range and that range.' It may be negotiable between the client and the provider in the PDS, but it is very difficult—in fact, our committee would say impossible—to state in a specific dollar term what the benefit would be to a client.

Senator CONROY—Are we talking here only wholesale clients?

Mr Rappell—No, we are talking people who are technically at law retail clients as well.

Senator CONROY—Is that because of the definition? I know we have discussed this previously in terms of dollars. Do you believe the definition is the problem?

Mr Rappell—I think the issue is not so much whether the wholesale-retail definition is a problem. Where it is difficult is for over-the-counter products, particularly risk management style products, where the action or reflex of that particular product is different to an investment style product.

Senator CONROY—You mentioned that ASIC are already supervising one of your members.

Mr Rappell—Taken enforcement.

Senator CONROY—What does that involve? What has happened, what action have they taken and what behaviour is now required?

Mr Rappell—We have been advised of this by an adviser of that particular firm. I am not sure that I can say—

Senator CONROY—If there are confidentiality issues, that is a perfectly reasonable response.

Mr Rappell—There are confidentiality issues, but I can say that we do understand there is a member who, in not stating the specific dollar amount in a PDS, has been warned by the enforcement division of ASIC that a range, for example, of fees is not satisfactory.

Senator CONROY—Is it under this regulation that action has been taken?

Mr Rappell—I am not sure of that to be perfectly honest, but it is the same point.

Senator CONROY—A regulation is in force from the moment it is gazetted. I would be surprised, given that we are still going through the parliamentary process, if ASIC had been that zealous.

Mr Rappell—Would you like me to see if I can research and come back to the committee with further details?

Senator CONROY—Any information on that would be useful to the committee.

Mr Rappell—I would be happy to do that. I think it is an interpretational issue, because what we are really talking about here is whether it is a specific dollar issue or we can talk about it in dollar terms which is a range—not universal, but a narrow range. To bring this down to a basis where we are talking about a range of dollars or a range of percentages and worked examples would improve the regulation immeasurably.

Senator CONROY—The reason I am asking is that I am finding it hard—not impossible—to believe that it is a breach of this regulation rather than a breach of the existing law. I could be wrong on that, but I would not have thought ASIC were enforcing this regulation just yet. That would suggest that they have broken the existing law, which means this regulation is not relevant and the case you are making may not be relevant to this regulation.

Mr Rappell—I take your point. I would like to do some further research on it, but I just tender this: I think that there is a pre-existing regulation about disclosure of dollar amounts, and I think that is being interpreted. We understand it is being interpreted narrowly by ASIC.

Senator CONROY—ASIC are up next, so I will get a chance to—

Mr Rappell—I see them behind me now.

Senator CONROY—They are looking over your shoulder as you speak. Actually, ASIC are up last; Treasury are up next.

Mr Rappell—They will have a chance to respond. In fact, I think we have got the division behind us.

Senator CONROY—There are some very ugly looking enforcement officers right behind you. I am talking about Mr Johnston now, just in case there is any confusion!

Mr Rappell—Exactly; I spotted him before. We say that the impossibility standard should be replaced by one which recognises there are some charges and pecuniary and other benefits, especially other benefits which it is not reasonably practicable—notwithstanding your earlier comments, Senator—to disclose in dollar terms because they are simply not quantifiable in dollar terms. This is the advice of our committee. We have suggested an example wording for the sections—as you know, the sections are roughly similar in terms of their wording—which provides that the dollar rule can only be avoided where it is reasonably practicable to do things another way because the information is not quantifiable in dollar terms; that is, it is not imposing a subjective test, allowing the drafter of the disclosure document to decide what is reasonably practicable or not. It applies only where the information is just not quantifiable in dollar terms. In our proposal for the work dollar examples, we would also like to replace the words 'work dollar examples' with 'worked examples', removing the word 'dollar', if it is accepted that particular charges and other benefits are not quantifiable in dollar terms or as a percentage.

In summary, our proposal solution modifies the ASIC determination test and the concept of 'compelling reason', which of course would have to be assessed in advance by persons preparing disclosure documents. It recognises that some charges and benefits are simply not quantifiable in dollar terms, and provides two alternative methods. We have got a proposed drafting for you. Absent of that particular proposal being accepted, I think that ASIC should consult widely with industry to develop some clear guidance about what compelling reasons would be, so that this gives people some room to move on devising their PDSs. This could include criteria to help licensees proceed with certainty when they are doing that. Alternatively, some guidance to regulations might useful.

Our committee also believe that the deadline of having this done by 1 July 2004 could be a difficulty, particularly in the area of over-the-counter financial markets, where we are talking about a very large amount of PDSs being issued—not by number of clients but by number of varieties of different PDSs, unlike some evidence that has been given tonight, where people are looking for an industry standard PDS. With the number of PDSs to be examined, it could be quite difficult to get through in an orderly manner by 1 July 2004 when this all becomes enacted. We believe also that there should be ongoing monitoring of this to see how it actually works in practice. That ends our opening statement. Thank you.

Senator CONROY—I think I interrupted along the way with all the questions I had.

Senator MURRAY—I must apologise to those who have been here for a long time, because I have had to rush backwards and forwards to the chamber. I almost regard these sessions as wrapping up a parcel which has already been bought and packaged and is ready to go, and we have just got to decide on the final colour of the wrapping paper. I have got my mind set on what is the next stage. To my mind, there are two next stages. One quite a long way down the line would have to be a review to see if the architecture, if you like, of the whole thing works, and how effectively it operates, and how it could be improved, and I do not want to focus on that now.

The other area I have explored a couple of times today has been the reporting side of things. The first issue was to get people to disclose what consumers would expect when they purchased a product or a range of products. The more important thing is the actuality and the report back to them as to what it actually costs. In the first, comparability is required so that you can decide

whether your investment choice is the best that meets your circumstances. Once you have made that decision, you are in a tunnel, but you really want to establish whether your actual fees and charges match or reflect the estimate given to you at the beginning. That is particularly important with market-affected products. I have asked this question of others. Do you see any difficulty in the provision to a customer of the actual fees and charges they have paid in totality in a given financial year so that they are able to see the reality against the estimates?

Mr Rappell—Senator, could you clarify that? I presume you mean before the event.

Senator MURRAY—No. The whole legislation focuses on the prospective nature of investments. I am talking about being retrospective. I can give you two examples. One is where you might be assessed by the tax office to be of variable income, and they therefore give you a provisional tax estimate. When you come to put in your return, you get the actual tax estimate, which always differs from the estimate. That is what you are after. Another example I would give you is a lease situation. Probably a third or more of the lease will be outgoings, which are variable. You have an estimate when you sign a lease, but at the end of the year you realise what the outgoings actually did come to and what they accumulate to. So the important thing for a consumer is not only to have an estimate of what they are committing themselves to but also to realise subsequently what the real impact of that is, particularly where fees and charges are tied to market variable instruments.

Ms Cass—In relation to OTC transactions, there is not really a fee or charge. The client just gets a price quoted, so there is no fee or charge. Another important point to note is that each transaction is tailored to the individual client at the time of dealing. It depends on the size of the transaction, the volatility of the market and the liquidity of the market. All that client gets is a price, depending on the time of the transaction. So no actual record is kept in a dealing room anywhere that I am aware of of a fee and charge in relation to each transaction, because the client only gets a price.

Senator MURRAY—Either you have not understood me or your business world is different from that of witnesses I discussed this with earlier, because they clearly indicated that there were variable fees and charges during the year for some products that are affected by this legislation and that it would be perfectly feasible to provide a statement. I am aware, for instance, with insurance products that many of them provide an annual statement at the end of the year. That indicates exactly what the fees and charges for that year have been—and they vary year by year because of the nature of the market movements. So your response confuses me.

Mr Rappell—Can I add to the comments by Debra Cass. To the extent that fees and charges are levied on a customer or a transaction throughout the year, it may be possible to give a report to the customer. However—

Senator MURRAY—Do you object to that in principle?

Mr Rappell—As we represent an association, we would have to refer that to the association and come back to the committee. I do not think there is a specific answer that I can give you uniformly and categorically today. I think it is theoretically possible. To the second part, there are a number of other issues in these regulations, apart from fees and charges, that are not measurable ex post facto—for example, benefits of using a risk management instrument as

opposed to an investment. One of the differences here is that we are looking at risk management instruments as opposed to investment instruments. The operation of those risk management instruments, when two counterparties are dealing directly with each other and not through an intermediary, is different to an investment instrument that you invest in via an intermediary.

ACTING CHAIR—As there are no further questions, Ms Cass, Mr Farrow and Mr Rappell, thank you for appearing tonight.

[8.25 p.m.]

ROSSER, Mr Michael John, Manager, Investor Protection Unit, Corporations and Financial Services Division, Department of the Treasury

WILESMITH, Mr Brett Anthony, Analyst, Corporations and Financial Services Division, Department of the Treasury

ACTING CHAIR—I now welcome to the table officers of the Treasury. The committee prefers that all evidence be given in public but, should you at any stage wish to give any part of your evidence in private, you may ask to do so and the committee will consider your request. Mr Rosser or Mr Wilesmith, do you have an opening statement, or do you want to go directly to questions?

Mr Rosser—I would like to make some opening remarks.

ACTING CHAIR—Please go ahead.

Mr Rosser—As you would appreciate, the testimony tonight has covered a range of different areas, so I thought it would be useful if I made a few comments and observations about some of my impressions of the testimony and some issues that have come from it. The first thing I like to say is that a lot of the discussion tonight has been about the presentation of information, as opposed to the obligation to provide it in the first place. To some extent, there is a question of whether the obligation is sufficient, and I think some of the witnesses have suggested that it is not. Then there is a broader question of how the information should be presented.

I would like to make the point that the legislation goes to some of the issues that have been raised. For example, the legislation goes to an obligation to provide information on costs and not just on fees. In other words, it is not merely the terminology that is used; the obligation goes to the character of the amount in question. Generally speaking, some of the evidence that was provided earlier gave some implication that there was, if you like, a bit of a vacuum in terms of the regulatory obligation. I would like to say that I do not believe that that is the case. The question is the way of giving effect to the obligation, which I think is obviously an important matter.

In relation to the ASIC brokered fee template or model, or whatever terminology you would like to use, the process, as I understand it, was one of ASIC carrying forward the recommendations of the Ramsay report, in terms of informing it on how it should administer the legislation and using the Ramsay report recommendations to stimulate ideas and issues that needed to be dealt with and resolved both by ASIC and industry. The process that followed from that—and I do not want to tread on ASIC's toes; they will obviously have some comments to make on this—was one of trying to work with industry on issues of common interest and to work with industry to develop, to the extent possible, consensus on some issues. For example, terminology, is an easy one; a more difficult area is the single figure disclosure issue, which obviously is a little more contentious. The point I would like to make it is that the result of that was, if like if you like, an interim one in that ASIC released a table and, at the same time, invited

comments and encouraged industry participants to test that model and provide feedback through that forum so as to lead to improvements of that model. That is a very constructive process and has led to contributions from Chant West and others, which is a very valuable contribution to the process, and I understand that that process will continue.

There has been some discussion of periodic statements, as opposed to product disclosure statements, and I think that is one thing that makes this area difficult in that the legislation covers a range of different situations. It covers: before the transaction, a financial services guide; at the time advice is given, a statement of advice; and, after the event, either a periodic statement for a product that is held or a confirmation document for a transaction such as a share trade.

So the legislation and the regulations have to deal with that diversity of different types of documents. They also have to deal with a range of different situations within that—different types of products, different characteristics of products and, in particular, whether or not they are expressible in dollar terms. As you are aware, Treasury has released batch 8 regulations in draft form for the purposes of consultation. This forum is an excellent opportunity to get feedback on the issues that have been raised about that. We appreciated that some of these issues were around because we received specific submissions on them—and I have found tonight very useful in helping to understand some of the other issues that had not come to light. I am happy to answer further questions.

Senator CONROY—I want to talk about the obligation issue. You mentioned some earlier evidence. Which was the evidence you were specifically referring to in terms of people saying that they did not believe it was an obligation?

Mr Rosser—I would prefer not to be too specific. Obviously, there were a lot of people who were enthusiastic for better and improved disclosure. From our perspective, I suppose we are looking at it in terms of what the legislative obligation is. Broadly speaking, a lot of that desire for disclosure is expected to be manifested under the FSR as the documents are rolled out.

Senator MURRAY—I would like to just explore a contradiction—and I must be careful as I was not here for the entire hearing, as you know. It struck me that there was a contradiction between those who said that the legislation as amendment gave more 'wriggle room' for people to avoid full disclosure and others who said that it is so tightly constructed that virtually everyone will have to disclose because of the compelling reasons structure. Those two different interpretations struck me as odd. Did you pick that up? Would you have a comment on it?

Mr Rosser—I did not pick it up as clearly as that. I would be surprised that people took away the interpretation that the standard had been lowered. I think, pretty unambiguously, the requirement has been raised—

Senator MURRAY—I thought so.

Mr Rosser—more by virtue of the possibility aspect rather than the compelling reasons aspect.

Senator MURRAY—My impression is that the amendment makes it very tough for anyone who does not disclose—and they do have to have a genuinely compelling reason that it is

otherwise impossible for them to do so. People put on the record that we should be concerned about the cost of compliance, but if you were concerned about the cost of compliance then you would have the act—because the act requires disclosure. I can see you nodding—as you know, nodding is not picked up by Hansard—but I would appreciate your comment on that.

Mr Rosser—I think the important thing is to appreciate the role played by the act and the embellishing role played by the regulation in giving effect to it. In terms of the 'wriggle room' as you called it, I think the regulation is intended to give effect to the act but do so in a way which acknowledges and allows the flexibility to deal with the variety of situations that witnesses have mentioned and I have mentioned. So the intent was to provide that degree of latitude but within a framework where the primary obligation is to disclose in dollar terms if that is possible. The question is how to qualify the possibility. That is the purpose of having a regulation—to have a qualification of that of some character.

Senator CONROY—I think you had the misfortune to sit through the parliamentary debate on this. My recollection is that the original legislation tried to put a lesser test on its and that that was defeated on the basis of a stronger test being brought forward in the regulation.

Senator MURRAY—A stronger test in the act, which is reflected in the regulation.

Senator CONROY—Yes, so what you have done is consistent with the act and its intent.

Mr Rosser—In a sense, what we have attempted to do is give effect to the act in as reasonable a way as could be done with the expectation that there would be issues that would arise because of the severity of the test.

Senator MURRAY—As you know, the compelling reasons approach requires an administrative law mind rather than a judicial, or a court orientated, mind. As a person with experience and judgment in these areas, do you have any reason to doubt that ASIC will be able to properly adjudicate in those terms? I do not ask you idly; I ask you because the witnesses have said that is not common phrasing in this environment. Yet, to my mind, it is a very clear way of expressing a requirement that would be stringently examined.

Mr Rosser—One of the things we would anticipate is that, if the regulation were to be reformulated, it would be reformulated in a way which would enable ASIC to provide class order relief. At the moment, the way it is framed precludes that possibility. It perhaps needs to be reformulated to permit that. That will address some of the issues about prevetting of documents and being able to deal with classes.

Senator MURRAY—Classes of product, rather than classes of provider, I presume?

Mr Rosser—It could be either.

Senator MURRAY—Senator Conroy?

Senator CONROY—I do not have any questions for Treasury.

Senator MURRAY—Mr Rosser, you have consulted very widely on these matters. Have you at any time addressed, even just in passing, simply because it is before you by the nature of the product, the issue I have been pursuing—that is, the actual record of what people have paid in a past financial year being made available to the customer or client as a matter of form? Have you come across that at all? Do you have any views on that?

Mr Rosser—The legislation deals with, in effect, several forms of post-transaction provision of information. One relates to periodic statements—the monthly, quarterly, annual statement for a product that is held longer term. There are legislative rules about the content, including the costs. I will pass to Mr Wilesmith in one moment to elaborate on those. As well as that, the legislation requires confirming documents for transactions such as share trades, for example, which again are intended to provide information about the cost of the transaction.

Senator MURRAY—I understand those are there, but I was looking for the ability of the customer to get a link between the information that is reported after the financial year has passed and the estimate that was made when they entered into the contract for that particular product. I do not recall that link being apparent in the legislation.

Mr Rosser—Broadly speaking, ASIC might have some comments on this, but that is the sort of thing which might carry forward in terms of the consultations that ASIC is undertaking at the moment with industry on the fee template. There are other possible applications of that same approach in other documents—specifically, periodic statements.

Senator MURRAY—From a Treasury point of view, the approach that I am suggesting is a good one and is within the broad philosophy and intention of the act—that is, to disclose both the estimates and the actuality of what fees, costs and charges amount to—isn't it?

Mr Rosser—The way I would put it is that the intention is to allow decisions to be made in an informed way with relevant information. For example, if a decision is to leave a product and to join an alternative then the documents in question might be the most recent periodic statement, say, for a superannuation fund and the product disclosure statement of an alternative fund, and perhaps of the existing fund as well. The general intent is to provide people with comparability and decision-making capacity. So it goes to having the documents compatible, if you like.

Senator CONROY—You would be aware that the industry is not excited about a degree of disclosure that allows these comparisons—that allow people to change products—and you would expect that to be the case. Is that fair?

Mr Rosser—It is fair to say that industry is not always excited about regulation.

Senator MURRAY—My concern is this: it is such a huge market that ASIC will be able to regulate almost on a sample basis only and provide broad guidelines for everybody else to comply. There may be circumstances where a provider inadvertently—or deliberately, if they are malicious—makes an estimate which does not match up to the reality of the costs and charges. When a customer becomes aware of the reality of the costs and charges they may choose to say, 'We want to exit this product and go somewhere else.' That is what is in my head—so that you have the confirmation that the basis on which they made the decision was justified.

Mr Rosser—There are rules about the content of the product disclosure statement, including that it cannot contain misleading and deceptive material. So a provider would have to be very careful if they were seeking to, if you like, gild the lily about how far they could go before whatever they were providing became misleading and deceptive. There are severe penalties in terms of both regulatory action by ASIC and recovery by investors. So I guess our expectation is that providers will be very mindful of the liability that attaches to the document.

Senator MURRAY—People should know that there are severe penalties for insider trading, but they still do it.

Senator CONROY—Senator Murray's point is that you get an estimate, but making the final judgment that you want to change products will only be possible once you have received the actuality.

Senator MURRAY—That is right.

Senator CONROY—You do need them both. I think the test you described encompasses what Senator Murray was describing. I just want to make sure that that is how you will encompass it. A person can only make the decision to change once they get the actuality in the periodic statement.

Mr Rosser—I would not go so far as to say that they can only make the decision then, but that would obviously be of assistance.

Senator CONROY—It would be a large factor that would bear on their decision.

Mr Rosser—They might, for example, be triggered to think about making a decision when they receive their periodic statement.

Senator CONROY—That is a fairer way to describe it. I appreciate that.

Senator MURRAY—Mr Wilesmith, I interrupted you several times. Would you like to finish anything you were saying?

Mr Wilesmith—The only point I would make there is that in looking at fees and charges—and, more generally, in describing the amounts payable by the holder—the wording for the up-front disclosure document is consistent with that for the periodic statement, so the obligation is consistent across the range. All of the regulations that we are looking at in batch 8 apply to all of the relevant disclosure documents—the up-front disclosure in the PDS, through to the periodic statements that you were also inquiring about.

Senator CONROY—What is Treasury's view of whether percentages are disclosed as amounts?

Mr Rosser—Whether they should be?

Senator CONROY—What is your view in terms of percentages versus amounts?

Mr Rosser—The legislation requires amounts. The legislation, before it was amended, significantly required amounts.

Senator CONROY—So amounts are necessary?

Mr Rosser—I think Mr Wilesmith might want to embellish that in terms of what the regulations—

Mr Wilesmith—The general reference within the act and the regulations is to 'amount' or 'amounts'. It goes further when percentages are given—then, if appropriate, worked dollar examples are provided as well.

Senator CONROY—'If appropriate' or 'where possible'?

Mr Wilesmith—If appropriate.

Senator CONROY—What is your definition of 'where appropriate'?

Mr Wilesmith—'In the relevant circumstances'—that could be a broad range of circumstances, as we have outlined in the legislation, that it is trying to cover off. Indeed, certainly with a range of issues, you are not only dealing with a particular set of circumstances or a particular type of amount that is being paid; you also have to take it in terms of the entirety of the document.

Senator CONROY—I am confused about 'where appropriate' and 'compelling'. One is a lesser test than the other.

Mr Rosser—It is a test that applies after the compelling reasons in terms of the structure of the regulation. So if compelling reasons indicate that it should not be disclosed in dollar terms then there is an alternative, and the alternative includes the possibility of disclosing through examples.

Senator CONROY—That has cleared that up; thank you. Does an amount include a percentage? Some would argue that they were the same thing. Some advice is that percentages do not need to be disclosed, because they are not an amount. So there are two angles to that—two different arguments, both ending up with the same result: less disclosure.

Mr Rosser—The intention of the legislation was to generate when it was an amount, a dollar figure of that. That was the broad intention. But obviously the legislation is also intended to provide a degree of flexibility in a diversity of situations.

Senator CONROY—I am just worried that somebody might argue that a percentage is not an amount and therefore we do not need to put the percentage in even. As you know, it is gradations of what is humanly possible here and they are pretty tricky buggers, this lot, and I am just trying to get an understanding of where you are coming from on it.

Mr Wilesmith—In terms of the regulations that are drafted there, it is precipitated by the idea that dollar disclosure is the requirement there in terms of providing information on costs and any

other items payable by the holder—and then it cascades down through a percentage or a wider description, as appropriate.

Senator CONROY—So that is how you see it, and that is the intent that you are trying to get?

Mr Rosser—The intention is to provide information, and then the next question is how to present that information.

Senator CONROY—That is all I have.

ACTING CHAIR—There has been evidence from a number of witnesses about the transition period. Both IFSA and the Australian Bankers' Association expressed concerns about the length of the transition period and suggested that it be extended to the beginning of the 2005-06 financial year. I think you have heard their evidence. Can I invite you to comment on that?

Mr Rosser—Just to clarify that is in relation to the batch 8 regulations?

ACTING CHAIR—Yes.

Mr Rosser—We anticipated that that would be one of the issues that would arise. The reasonably practicable test that was formerly in the regulation was intended to accommodate the temporal aspects of capacity to meet the disclosure obligation. So we anticipated that if the standard was raised then the temporal aspects would be even more acute. We are conscious of the fact that it is a regulation in draft form and, therefore, ASIC's capacity to provide guidance on it is somewhat limited and obviously the final form of the regulation is yet to be determined. So with the approach of 1 July I can understand that people have concerns about that.

ACTING CHAIR—Thank you, Mr Rosser and Mr Wilesmith.

[8.48 p.m.]

ADAMS, Mr Mark, Director, Regulatory Policy, Australian Securities and Investments Commission

JOHNSTON, Mr Ian, Executive Director, Financial Services Regulation, Australian Securities and Investments Commission

McALISTER, Ms Pam, Director, Financial Services Regulation, Legal and Technical Operations, Australian Securities and Investments Commission

ACTING CHAIR—Welcome. Mr Johnston, do you have an opening statement?

Mr Johnston—Yes, thanks, Senator. As always, ASIC is pleased to assist the committee in its deliberations. A key element of the proposed regulations is the requirement in relevant disclosure documents for amounts to be disclosed in dollar terms. ASIC supports the notion of dollar disclosure as we believe, and research demonstrates, that fees, costs, charges and commissions are best understood by consumers when expressed in dollar terms. I would, however, draw the committee's attention to the fact that the proposed regulation moves the requirement for dollar disclosure from being 'unless it is not reasonably practicable' to 'unless ASIC believes it is not possible for compelling reasons'.

There are a couple of points to be made about this, I think. Firstly, 'not possible' seems to us to be a near absolute test; something is either possible or it is not. Secondly, it is unusual to ask the regulator to make such a determination, arguably before the fact. On one interpretation, and unless ASIC have the power to issue class determinations, ASIC could be called on to make a determination in some hundreds of cases. If this were to eventuate, ASIC would not currently be resourced to make such a large number of determinations. More commonly, ASIC would, in the normal course of its duties, apply the law by reviewing a proportion of disclosure documents and through its compliance reviews. Our current resourcing certainly allows us to do that.

The point to be made here is not so much that we do not believe it is appropriate for us to fulfil this obligation but, unless there was an ability for us to issue class determinations, we may be called upon to deal with some hundreds of matters in a short space of time, especially with the introduction of this requirement. As noted earlier, ASIC believes that dollar disclosure is the most appropriate form of disclosure for consumers. We make this clear in our discussion paper which introduced the ASIC fees and charges table. This document was prepared to assist regulated entities in meeting their disclosure obligations and to assist consumers by showing all fees and charges in the one place in the disclosure document. Could I make one point of clarification, in case there is any doubt from earlier evidence, that the Corporations Act and the ASIC fee table require disclosure of all fees and charges, including upfront fees and ongoing fees. The table was to focus on the transparency of fees and charges and on standardising fee labels and presentations.

In releasing the model we made several things clear: we called on industry participants to test the model with consumers; we said that the table would be subject to review and that the model

was only one part of the work that needed to be done; and we acknowledged that work should continue on other comparability tools. However, we saw the fee table as being an important first step. To this end, we are aware of further industry work that is going on. We have also convened a roundtable discussion with interested parties later this month. We are happy to answer any relevant questions from the committee.

Senator MURRAY—I liked that last remark, being happy to answer any relevant questions, so I assume he will just bat the irrelevant ones away.

ACTING CHAIR—Irrelevant questions will be overruled by me, but I am sure your questions will always be relevant.

Senator MURRAY—Thank you. I would like to ask you to do what Treasury did and give us a view on the accumulated wisdom which the committee has been subjected to today. I note that you have been here for longer than I have, so you might well have a more complete view than I have. I would like your response to some of the concerns that have been expressed.

Mr Johnston—It is definitely true to say that the new requirement is a more onerous obligation in terms of disclosure. It is clear to me that there would be no 'wriggle room', as it was described by people giving evidence earlier today. It is clear to us that it has always been the intention that all fees and charges need to be disclosed, and now the bar has been raised further by saying that there have to be very strong grounds as to why that disclosure should not be in dollar terms. It has always been ASIC's position that dollar disclosure is the ideal, and we have made that clear in our policy statements and other information that we have released to the marketplace. I think that the current form of the proposed regulation makes it crystal clear that dollar disclosure is what needs to occur, unless there are compelling reasons as to why that is not possible.

Senator MURRAY—Have you tested the water on compelling reasons? Has anyone approached ASIC and said, 'These would be our compelling reasons. What do you think of them?'

Mr Johnston—Not yet. I anticipate that we would go through a process of doing just that, though. In all likelihood that would look like our normal policy proposal paper type consultation, where we might put forward some examples of where we might accept disclosure in other than dollar terms. Those would probably be reasonably generic examples, rather than trying to be very specific on a product basis, because that would narrow the consultation. We would probably also give some examples of where we would not accept an argument that something was not possible and would therefore allow the industry, consumer groups and anyone else who is interested to come back to us and tell us what they thought. It would be important for us to issue some guidance on this. It would also be important, as I said in the opening statement, for us to have the ability to make some class determinations to ease the administrative burden.

Senator MURRAY—There are two classes of relief. One would be to provide class relief, for instance, but the other would be to recognise difficulty of implementation and allow people greater time in which to comply. It seems to me that, when you have a witness who says that the cost of compliance could be considerable for a small provider who will have to acquire new software and get it properly designed and checked and so on, the business side of me has a bit of

sympathy with them, but the legislator side of me says that I know that the act produces compliance costs. The practical side of me says that those are circumstances in which you might give people a bit of breathing time, whereas a very big and well-resourced organisation would not have that same breathing time. Do you have the means or the mechanism to provide relief on those two bases?

Mr Johnston—I would suggest that, with the current form of words, it would be difficult for us to take account of transitional issues. That might need to be specifically recognised, perhaps in regulation. Because of the words being 'not possible', it is difficult for us to then apply that standard with some discretion. I think something is possible or it is not. As I said, it is almost an absolute test. So I think that there probably should be some transitional recognition of the difficulties, but that might be better done in the regulations themselves. It is always possible, though, for us to grant relief—

Senator MURRAY—Can I just interrupt there. Are the regulations a competent vehicle to give you that transitional flexibility?

Mr Johnston—Yes, I think that would be the most competent vehicle.

Senator MURRAY—And that is within the power under the act?

Mr Johnston—I would say so, but I would stand corrected by anyone with better legal expertise than me. I would think that that could be accommodated. I think that would provide greater certainty, because, if we were to be asked to say that something is not possible for compelling reasons simply because it is difficult, that just would not seem to work, to me.

Senator MURRAY—Instinctively, I react better to your regulatory route than to a legislative route. A legislator knows that, if you allow a transitional provision, everybody will dive into that transitional provision. It will just take forever to happen. It is much better in a regulatory sense. Would you envisage first testing the market, establishing what the difficulties are and then going back and saying, 'We need the regulation adjusted', or would you envisage a situation whereby this process says, 'We had better be realistic and recognise that there may be those people who require a little extra time and the regulations should enable that relief to be provided by ASIC'?

Mr Johnston—Can I answer it this way. I think that either you allow everyone a period by which to comply or we try and do it on a case-by-case basis. I think that, the way the words are expressed at the moment, it would be difficult for us to do it on a case-by-case basis because of the test being so high.

Senator MURRAY—Let me ask you this question. I asked earlier whether 'class' meant 'provider' or 'product'. The answer from Treasury was 'possibly' or 'probably'—I cannot recall which word they used—both. You could certainly provide transitional relief by class of provider, not to everybody. You could, for instance, do that for very small providers who would obviously have greater resource difficulties. I am not suggesting you do; I am just thinking aloud.

Mr Johnston—I might not have made myself clear. When I said that it could be done by regulation, I actually meant by promulgating regulations. I think that would be the better way to

handle the transition issues because it would provide greater certainty. When I said by regulation, I was actually meaning by regulations.

Senator CONROY—So you meant that Treasury should do something else or something additional?

Mr Johnston—At the risk of upsetting people who might still be in the room: yes.

Senator CONROY—What is it that you think they should do?

Mr Johnston—If there is to be any transitional relief, we think that it will be better done by regulations.

Ms McAlister—Could I proffer a suggestion? Just for an example, if the existing regulation allowed a transitional period in cases where there was an unreasonable burden, only on a short-term basis, that might accommodate the sorts of situations that I think Senator Murray is alluding to; but that would only apply during a transitional period.

Senator MURRAY—I am not trying to promote this, because I can see all sorts of dangers if you open up the floodgates. I am not trying to do that at all. But I do recognise that some witnesses have raised one of the issues in getting to grips with this in the short term as being the cost of compliance and the practical business of going from a regulation which becomes a reality in perhaps a month's time, or whenever this process is finished, to the time of compliance, which is 1 July 2004. I can envisage, practically, that some people may have difficulties, and I just wonder how you would handle that.

Mr Johnston—We would not be opposed to there being some transitional period. It may be that it could be an across-the-board extension of time, if you like, or it could be more tailored than that, whereby there would have to be some grounds demonstrated before the transitional relief could be granted—although, as I said, we would have the view that it would be better to make that certain by covering it in the regulations rather than doing it by way of ASIC relief, especially because we would be likely to receive such a large number of applications.

Senator CONROY—I do not understand. If people have a problem complying, a 12-month waiver is not necessarily going to help them and you are still going to be flooded, as you describe. All you are doing is seeking to put it off for 12 months. Like Senator Murray, I am not keen on transitional periods, for the very reasons he has articulated, but, like Senator Murray, I also accept that there are some practical implementation problems. You are trying to make a suggestion, so I am trying to understand the implications of the suggestion.

Mr Johnston—If we were dealing with the old language here—that is, 'not reasonably practicable'—if an entity came to us and said—

Senator CONROY—Nobody would actually be revealing in dollars. Let us be realistic.

Mr Johnston—Certainly our position would have been that there would have to have been compelling reasons why they would not disclose in dollars under that test—

Senator CONROY—These are your own words, so I am struggling to understand why you have a greater problem, given that you actually mandated your own words.

Mr Johnston—No, I do not know that we have a greater problem; I am just trying to illustrate that if that were the case—if those words were used—then I could see how we could, within those words, give someone more time. We would not accept something which might not be reasonably practicable today as not being reasonably practicable within three months, six months or whatever period it might be. But where the words are 'not possible', I do not think that gives us any room to move on that issue, and that is why we think it would be better dealt with by way of regulations.

Senator CONROY—As Senator Murray and I mentioned on the floor of the chamber in December, we were promised three years ago at this very committee that it was not possible to introduce real-time disclosure on an ATM. We were told it was maybe two to three years away. We are now three years down the track from that, and nobody has bothered to do it because they did not have to, despite them promising faithfully that they were going to. So I am a huge sceptic. Unfortunately, in this industry, the people who made those sorts of promises and commitments two years ago are the very same people who are now fronting up saying, 'It is technologically hard for us to do.' So I am a bit of a sceptic when they say that to us and, like Senator Murray, I would be very worried if we were going to give a blanket transitional period for them to keep trying to push out and push out.

Mr Johnston—I am not suggesting that that should happen; I am suggesting—

Senator CONROY—That is what I am saying. I am trying to get an understanding of what you are putting forward.

Mr Johnston—If some sort of transitional relief is to be given, we are suggesting that it would be better to do it in the regulations rather than to rely on ASIC doing it.

Ms McAlister—I think what Mr Johnston is saying is that we do not see the scope of the current wording—'not possible for compelling reasons'—gives us the discretion to decide that something is not possible today but it is possible tomorrow. We think that it is a very high, strict test and that it does not allow for that gradual—

Senator CONROY—What sorts of words—and I am trying to take you up on your suggestion—would the regulation contain? I do not think we can amend the regulations, so it may have to be a new regulation or a withdrawn regulation replaced by a regulation with these words. It is not a simple parliamentary process. What would the words look like?

Mr Johnston—I think that would be too difficult for us to formulate here.

Senator CONROY—I appreciate that.

Senator MURRAY—You have not failed us before, Mr Johnston!

Mr Johnston—I obviously have.

Senator CONROY—Would you be able to come back to us?

CHAIR—Do you want to take that on notice, Mr Johnston?

Mr Johnston—Yes, we can take it on notice.

Senator CONROY—Obviously, we have a fairly tight deadline. We have decide whether we are going to disallow this or not in a relatively short period of time.

Mr Johnston—For the removal of doubt, we support dollar disclosure and we support that being an obligation that is imposed on everyone in the financial services industry.

Senator CONROY—I am not for a moment suggesting that ASIC does not. The argument then becomes what should be included in the dollar disclosure, as you are well aware. If you can come back to us on that, maybe Senator Murray and I can get a better feel for what your problems are. There has been an issue regarding disclosure of fees and charges relating to common funds. In the original regulations, an estimate was required for fees and charges for common funds. Could you advise whether you have reached agreement with the industry as to what a common fund is?

Mr Johnston—We are not at this stage in a position to say that we have completely canvassed everything that might and might not be a common fund.

Senator CONROY—What sorts of things do you think are common funds at the moment? Is there such a thing?

Mr Johnston—A very good argument would have to be put to us why something is not a common fund. I think that is the way that we would categorise it. The industry has come to us to suggest that some forms of life funds, for example, might not meet the test of being a common fund. That is not something that we had identified as an issue ahead of time; this is something that has been brought to our attention. We are looking at whether we think these things may be common funds or not. We would put the onus of proof on others to demonstrate that it was not a common fund.

Senator CONROY—The good news is that we are talking about the draft regulations, so it is possible for us to make an amendment, as it has not been tabled or gazetted. So any words that you or Treasury had in that vein would be very useful to the committee. It would be helpful. I am still keen to understand this common fund problem and whether or not it is being used as wriggle room to get out of disclosure, so I am trying to get a bit of an indication of your thoughts on what a common fund is.

Ms McAlister—How we view the common fund concept is that it is meant to capture the costs that an investor is indirectly bearing, the costs of a fund that are indirectly attributed to the investor—but perhaps not by directly debiting their account balance, for example. So, as a broad principle, if there is a pool of money and charges are being levied against that pool of money before there is a distribution of earnings, for example, to the investor then we would view that as the common fund and that therefore a notional allocation of the investor's share of those expenses ought to be disclosed.

Senator CONROY—That is a technological issue, in my view; they just do not have the systems set up to do that. Is that an unfair characterisation?

Mr Johnston—It is how they have put it to us in some cases, yes.

Senator CONROY—But that is technological. It might be a transitional issue and be covered by the very thing you are potentially suggesting as an amendment, but it is not a compelling reason.

Mr Johnston—They have also put to us, though, that there are some funds, which are generally life funds, where they think they do not have the characteristics of a common fund. We have not yet had a chance to look at that.

Mr Adams—We are just considering those comments they have put to us. The sort of argument is that there may be some forms of pooled funds for the life industry where the clients do not have any participation right in relation to the pool. There is a promise being made in terms of a benefit and, therefore, in that context, there is nothing from that which needs to be disclosed. That is what we are considering.

Senator CONROY—These are the very worst excesses of the industry, which have now been driven out. The industry keeps saying to me, 'These are the old ones,' and I am thinking, 'Yes! This is exactly why we're having the reforms we're having.' Some of the practices of the industry of years ago are an embarrassment to all concerned. I find extraordinary their defence of this situation: 'Oh, we couldn't possibly tell you, because we can't. It was so bad in the old days, we were able to hide it completely.' Whereas we have moved to a new, greater understanding and desire to protect consumers arising out of the very practices that they are now again trying to use to not reveal information. That was more of a comment that a question, I guess.

Senator MURRAY—I want to wrap up the theme I have been pursuing all day, which is matching the prospect of estimates, which hopefully are done on a comparative basis, with a variety of products. You make your choice and at the end of the financial year you want to know if the actuality matches the estimate. With some products, it is very straightforward; with others, it is very much affected by the complexity of the product and whether it is market related. You have heard the questions and answers, including those with Treasury. What do you have to add to the mix of information I have received on that front so far?

Mr Johnston—We would concur with the comments that Treasury made. The periodic statement ought to do the work of allowing an investor to know what the fees, charges and other costs have been of the investment over the period to which the periodic statement relates. One of the things that does occur to us relates to the form that we have required in the ASIC fee table, which splits out various fees and charges. Perhaps we might replicate that format in a periodic statement so that it is easy for the person to go to the original statement and see what was beside each item and then get the periodic statement and see whether it matches up and what the actual experience has been. That is probably the only additional comment that we might make.

It was always contemplated by us in the consultation process on the fee template that we would be going further than what we required with the fee template, but we were not at the stage yet of dealing with what the form of a periodic statement might be. It occurs to us that it should

be comparable to any fee template that is used. In that way, consumers and investors can then compare like with like and see what the actual charges and costs have been over the period.

Senator MURRAY—My feeling was that both the act and the work done consequent to the act had not sufficiently married or linked the forecast of cost, fees and charges to the reporting. In some circumstances it is very clearly linked and it is very easy to fit them together; in others I suspect it would be very difficult. I think that is an absolutely essential part of the disclosure regime, because it validates for a customer their purchase decision or, if it is different to the information they got when they began, even if there is no malice in the process, it may encourage them to exit and find a better product to suit their needs.

Mr Johnston—Indeed. Certainly all the information should be there in the periodic statement that would allow you to look back, but it may not have been required to be presented in the same format. If it were in the same format, it would aid comparability.

Senator MURRAY—If the committee were to make a comment along those lines, would you concur that that is the way to go?

Mr Johnston—Yes.

ACTING CHAIR—Thank you. That concludes this public hearing of the Parliamentary Joint Committee on Corporations and Financial Services. I thank the witnesses for their attendance.

Committee adjourned at 9.15 p.m.