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Submission: Regarding fee disclosure in managed investments in dollar terms on clients' statements

Submitted to: The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Room SG.64
Parliament House
CANBERRA ACT 2600

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As I understand it, one purpose of this Parliamentary Committee is to seek information to assist them in drafting regulations regarding dollar disclosure and the creation of an ASIC requirement that would require the disclosure in dollar terms unless the issuer was able to provide compelling reasons as to why this was not reasonably practicable.

What exact fees that the issuers would have to disclose is not entirely clear. The amendment that was inserted into the Financial Services Reform Amendment Bill 2003 is as follows:

88A After subsection 1017D(5)
Insert:
(5A) Unless in accordance with the regulations:

(a) for information to be disclosed in accordance with paragraphs (5)(a), (b), (c), (d) and (e), any amounts are to be stated in dollars; and

(b) for any other information in relation to amounts paid by the holder of the financial product during the period, any amounts are to be stated in dollars.

Note: (If so, the 5 (a), (b), (c), (d), (e) refer to subsection 1017D(5) of the FSR Act. The above is just amendment 5A and its a and b sections.)

It is item 5A (b) that seems to carry the most weight as it says "any other amount" paid by the holder of the financial product during the period to be stated in dollars.

What does this "any other amount" include? Does it include up-front commissions, trailing commissions, adviser services fees, member fees, management fees, administration fees and expense recovery fees? Of the myriad of fees charged to investors I think the regulations need to clearly define the fees that are to be disclosed.

Under the current legislation disclosure to investors is fragmented in such a manner that an investor receives disclosure in a piecemeal fashion. For example there is one disclosure requirement for product issuers to disclose relevant information in the Product Disclosure Statement (PDS). Although this may meet the legal requirement of disclosure it is far from effective as investors rarely read these 50-60 page documents. They tend to be a combination of a legal document and a marketing brochure and do not effectively educate investors about fees. Of course one could take the view that "buyer beware" applies and therefore the onus is on the investor to seek out the information. I believe that better disclosure will afford investors better protection.

A second area of disclosure under FSR is from the adviser in the "Statement of Advice". It is here that the clients have all of the fees received by the adviser clearly spelled out. This disclosure is often contained as part of a 60-70 page financial plan and I question its effectiveness. Very often when a client visits an adviser he is given a financial plan (with appropriate disclosure) and two or three copies of Product Disclosure Statements for the recommended investments. That is a lot of information for an investor to comprehend. The fees are disclosed on perhaps 4 pages out of 250 pages of information.

One could argue that clearly the fees have been disclosed to the client. However this disclosure is on a "one off" basis (when the client purchases the investment) and there is no allowance for continuous disclosure. An investor could purchase an investment product today that is heavily loaded with fees and several years from now be still paying excessive fees but be unaware as the fee disclosure was so far in the past. There are many examples of life insurance superannuation policies sold many years ago that fit this description.

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Another area of adviser disclosure that is legally correct but questionable is the common use of so called “nil entry fee funds”. In the case of products marketed in this manner the client does not pay an upfront commission per se but is locked into an agreement that forces him to pay an exit fee in the first four or five years. The adviser is paid their commission for selling the product and the client is almost always poorer because the annual fees on these products are 0.50% -0.70% per annum higher. A typical disclosure statement by an adviser selling a nil entry fee fund might read:

Product	**Commission received by adviser**
ABC Fund (nil entry)	3%

The adviser might than ad verbally ***“ Don’t worry Mr. Client. These fees are paid to us by the Fund Manager from their own resources and not paid by you. Don’t worry about the exit fee for the next four years as managed investments are long term investments and therefore you should not be affected by the exit fee***.”

The adviser neglects to mention that by choosing this option the client is paying a higher annual management fee. The higher annual management fee is disclosed in the product disclosure statement. Nothing illegal has been done as the adviser’s disclosure requirement has been met. As far as I am concerned this fee structure is designed purely to make the sale easier for an adviser and does nothing for the client but cost them more in fees in the long run. This deception could be minimised by continuous disclosure of fees on client statements.

Overall the effectiveness of disclosure by advisers is suspect as the majority of advisers are earning commissions from sales of investments. This fact coupled with the fact that ASIC does not have enough resources to adequately enforce the disclosure requirements on the 15000+ advisers supports the argument for requiring the product manufacturers to be responsible for disclosure of all fees on client statements.

The average Australian investor has no idea what fees they are paying because of the range and types of fees charged and a lack of effective continuous disclosure. The current disclosure requirements allow for the fund managers to disclose some fees in the Product Disclosure Statement while other fees are required to be disclosed by financial advisers in the financial plan or on the newly required statement of advice. This piecemeal disclosure results in an investor that is ignorant of the fees they are being charged or at best they are confused by the fact that they are only getting partial fee information from multiple sources.

The financial services industry (banks, insurance companies and fund mangers) 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. The investors themselves have no full time representation and groups like the Australian Consumers Association and the Australian Shareholders Association act on behalf of consumers as best they can.

This committee is in a position to draft regulations that will significantly affect the fairness of fees to investors.

Who should be responsible for fee disclosure and what is the most effective means of disclosure? 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.

The fund managers or product issuers are the only group to have the information on all of the fees as they collect the management fees, and expense recovery fees, operators' fees, member fees, upfront commissions, trailing commissions and even some adviser service fees

I therefore request the Committee to consider the requirement for ALL FEES associated with managed investments and superannuation funds to be placed on investors' statements in dollar terms including fees paid to and collected on behalf of advisers. Statements should be required to have a clearly outlined section on fees stating the following information in actual dollar terms.

All Management fees
All expenses charged
Any operators' fees or trustee fees
All administration or member fees
All forms of commission paid to intermediaries including
Up front commissions
Trailing commissions
Adviser service fees

Fund managers will argue that this is not practical or possible. However if managers are able to record, collect and distribute fees and commissions and pay fund mangers investment management fees it should be a relatively simple step to export this data to the clients' statements.

Once this type of continuous fee disclosure occurs the investors will regularly be advised of the costs associated with investment funds and be able to determine whether or not they are receiving value for money. Most companies issue statements at least semi-annually so the disclosure will occur on a continuous basis versus only at the time of the sale.

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Continuous disclosure will protect investors and the financial services industry will move one step closer to being a profession. To me this seems like a common sense solution. I have been advocating this type of disclosure requirement for the past several years and I sincerely hope that this Parliamentary Joint Committee will see the merits of these arguments and enact regulations requiring the manufacturers to be responsible for continuously disclosing ALL fees on clients' statements,

Continuous disclosure of the total fees charged to investors is the only real solution.

I am attaching a copy of some research I conducted last year that supports the full disclosure of ALL fees. The Management Expense Ratio (MER) is only one part of the fees an investor is charged. The total fees including the fees and commissions paid to the advisers/salespeople need to be continuously disclosed. In many cases the fees paid to advisers are equal to or greater than the costs of management.

I am available to testify at the committee hearing and I look forward to the opportunity to do so. Please feel free to contact me on (02) 9966-5020 for any clarification on any points I have raised in this submission. Thank you.

Sincerely

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