ASIC

Australian Securities & Investments Commission

Sale and distribution of investment products to retail investors

June 2009

About this paper

This paper provides an overview of how financial products are sold and distributed to retail investors. This paper has been prepared by ASIC to assist the Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services.

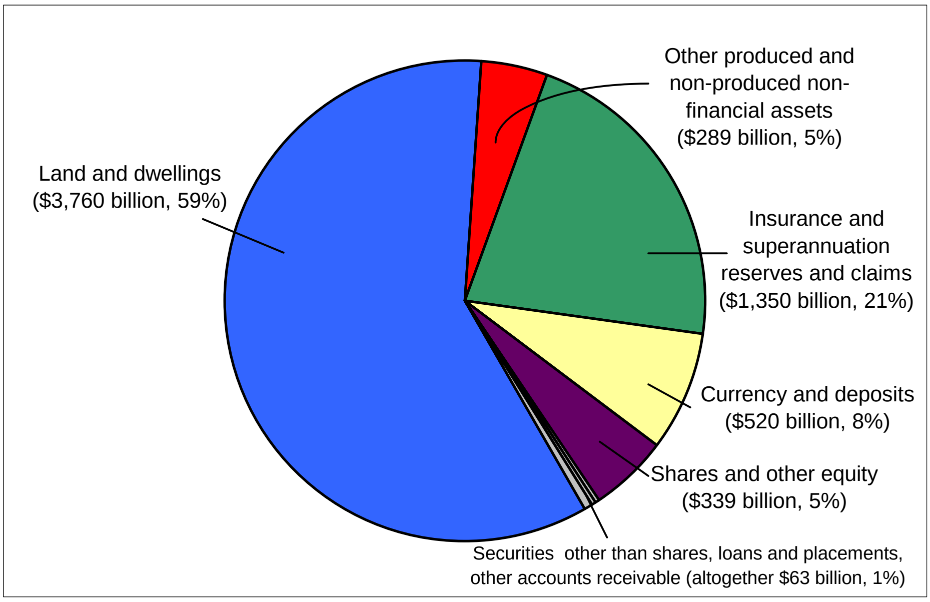
Contents

A What financial products do retail investors invest in?

The overall picture: what do Australians invest in?

1 The Australian Bureau of Statistics (**ABS**) estimates total household[1] assets at 30 June 2008 to be $6,325 billion.[2] Figure 1 shows this wealth by asset class. The majority of household wealth is held in property, not financial assets.

Figure 1: Allocation of household assets as at 30 June 2008[3]



Source: Australian Bureau of Statistics, Cat. No. 5204.0, *Australian System of National Accounts, 2007-08*.

2 The ABS estimates total household financial assets at 30 June 2008 to be $2,276 billion, or 36% of total household assets. Figure 2 shows asset allocation of household financial assets. Note that in this ABS data:

(a) insurance technical reserves includes superannuation assets and life insurance assets;

(b) currency and deposits includes everything from basic deposit accounts, to term deposits to units issued by cash management trusts;

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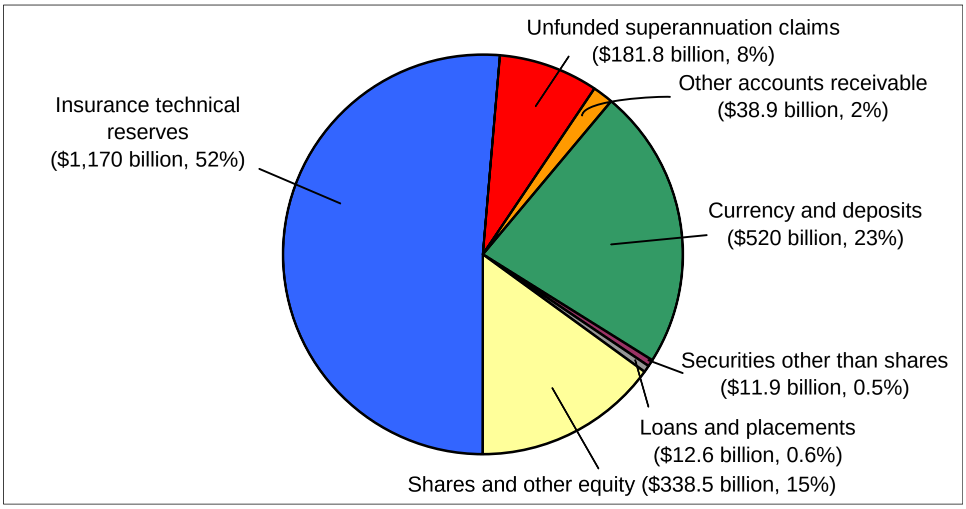
[1] In ABS data 'households' are individuals, families and small, unincorporated enterprises that are owned or controlled by individuals or families. Household wealth is a rough proxy for retail investor wealth.
[2] Australian Bureau of Statistics, Cat. No. 5204.0, *Australian System of National Accounts, 2007-08.*
[3] Australian Bureau of Statistics, Cat. No. 5204.0, *Australian System of National Accounts, 2007-08*

(c) securities other than shares includes tradeable debt instruments that give investors the right to repayment plus interest, such as debentures and bonds;

(d) loans and placements includes loans not represented by debt securities, and account balances with entities not regarded as deposit-taking institutions;

(e) shares and other equities includes most managed investments (other than superannuation) as well as company shares.

Figure 2: Allocation of household financial assets as at 30 June 2008



Source: Australian Bureau of Statistics, Cat. No. 5204.0, *Australian System of National Accounts, 2007-08*.

3 The ABS data indicates that investment in superannuation and life insurance comprises the majority of household financial asset wealth, followed by investment in currency and deposits.

What financial products do retail investors typically hold?

4 Apart from superannuation products, life insurance and currency and deposits (which are not the focus of the Inquiry into Financial Products and Services by the Parliamentary Joint Committee on Corporate and Financial Services), the main investment products typically held by retail investors are:

(a) shares;

(b) debt securities (including debentures); and

(c) managed funds (other than superannuation).

The total value of household investment in these investment products is around $350 billion or 5.6% of total household wealth.[4]

5 The rest of this paper focuses on these three investment products (i.e. shares, debt securities and managed funds (other than superannuation)) to assist the PJC inquiry into Financial Products and Services.

Shares

6 Retail investors hold shares directly. (They also invest in shares indirectly through managed funds and superannuation.) ANZ's 2008 study of financial literacy reported that between 2002 and 2008, the proportion of respondents with direct ownership of shares fell from 44% to 38%.[5]

Debt securities (including debentures)

7 Retail investors often invest in debt securities indirectly through managed funds, but they may also acquire them directly.

8 Debentures are a debt security that is generally held by retail investors. ASIC estimates that, as at 31 December 2008, there were 109 debenture issuers in Australia who had issued debentures with a total face value of $16.9 billion. The *ASIC Investor Research Report 2008*, by Roy Morgan Research (Roy Morgan ASIC Investor Research), found that 4.3% of investors surveyed directly owned debentures.

Managed funds (other than superannuation)

9 Managed funds allow investors to 'pool' their money in a fund, which a professional investment manager invests in a particular type or mix of assets with a view to receiving an ongoing return or capital gain.

10 At 31 March 2009 managed funds institutions had total consolidated assets of $1,169 billion allocated across a range of assets (see Figure 3).[6] (Note that, these figures include assets held by superannuation managed funds.)

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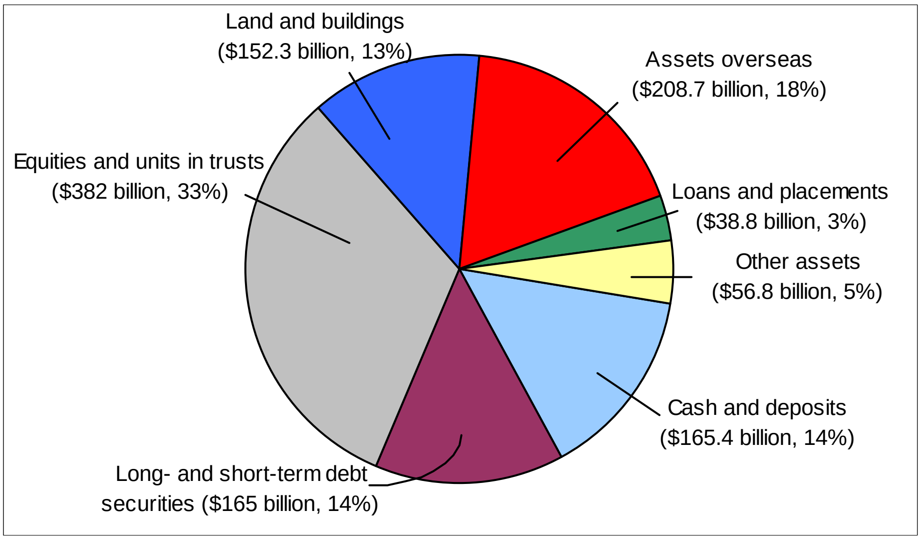
[4] As shown in Figure 2, household investment in debt securities at 30 June 2008 was $11.9 billion, or 0.2% of total household assets. The ABS data does not provide information on specific investments in shares and managed funds other than superannuation. However, the total amount of wealth invested in shares and other equity, which include investments in shares and managed funds other than superannuation, at 30 June 2008 was $338.6 billion, or 5.4% of total household assets.

[5] ANZ Survey of Adult Financial Literacy in Australia (2008 p.62), (2005, p.77).

[6] ABS, March 2009, *Managed Funds, Australia*, Cat No 5655.0.

Figure 3: Total funds under management – Allocation of assets as at 31 March 2009



Source: Australian Bureau of Statistics, Can. No. 5655.0, *Managed Funds, Australia, March 2009*.

11 Of the $1,169 billion, it is estimated that direct retail investment (excluding retail investment through superannuation funds) accounts for around $127 billion[7] (or 11%) of managed fund investment.

12 According to data from Roy Morgan Research, as at March 2006, the types of managed investments most favoured by retail investors were:

(a) cash management trusts (held by 32% of those retail investors who had invested in managed funds);

(b) diversified balanced funds/trusts (16%);

(c) Australian equity funds/trusts (14%); and

(d) life insurance (10%).

Other managed investments included diversified growth funds/trusts (9%); listed property funds/trusts (9%); international equity funds/trusts (8%); Australian bond funds/trusts (8%); ethical equity funds/trusts (6%); mortgage funds/trusts (6%); unlisted property funds/trusts (4%); income funds (3%); and international bond funds/trusts, diversified capital stable funds/trusts, friendly society bonds, hedge funds and insurance bonds (all around 1-2.5%).[8]

[7] Roy Morgan Research 2009, *Superannuation and Wealth Management in Australia*, p.6.
[8] Data from Roy Morgan Research, (survey period April 2005 - March 2006). This data does not include platforms, which, as a matter of law, are managed investment schemes. For more information on platforms see paragraphs 24–31 of this paper.

Who are the product manufacturers?

Shares

13 Retail investors are most likely to hold shares in listed companies as investments. In April 2009 there were 2,070 companies (1,988 domestic and 82 foreign) listed on the ASX.[9] Generally speaking, retail investors tend to invest in the ASX top 200 companies.

Debt securities (including debentures)

14 Debt securities are generally issued by governments, financial institutions and companies. Governments issue debt securities, such as bonds. Debentures are generally issued by non-bank financial institutions or companies, such as property development companies, looking to raise money. For example, Victorian Securities Corporations Ltd, a mortgage financing company and a subsidiary of Bendigo Bank, issues debentures.

Managed funds (other than superannuation)

15 While the funds management industry in Australia as a whole is relatively unconcentrated, the retail managed funds industry is substantially concentrated.

16 As of September 2008, Morningstar estimated that total Australian sourced assets under management by Australian fund managers were $952 billion, of which the top 10 managers held $518.8 billion (54%).[10] Retail funds under management were $465.8 billion, of which the top ten managers held $393.4 billion (84%). Retail funds under administration (i.e. on platforms) were $362.2 billion, of which the top ten managers held $332.6 billion (92%). See Table 1 for more information.[11] Note that this data includes money held in retail superannuation funds, but not money held in industry superannuation funds.

[9] ASX 2009, *Historical market statistics* (online) <http://www.asx.com.au/research/market_info/historical_equity_data.htm#No%20of%20Companies.

[10] Morningstar 2008, *Market share report*, September Quarter 2008. This data differs from the ABS data in paragraph 10 because it was compiled on a different basis.

[11] Ibid. Retail funds under administration refer to funds invested via platform products, and not actually managed by the financial institutions with which they are placed.

Table 1: Australian fund managers: Total funds under management, retail funds under management, and retail funds under administration[12]

Top 10 funds	Total funds under management		Retail funds under management		Retail funds under administration	
		$billion		**$billion**		**$billion**
1	Commonwealth–Colonial Group	$108.5b	National-MLC Group	$60.1b	National-MLC Group	$60.2b
2	Macquarie Bank Group	$73.4b	AMP Group	$57.3b	BT Financial Group	$46.6b
3	AMP Group	$64b	BT Financial Group	$54.4b	AMP Group	$42.6b
4	AXA Group	$51.1b	Commonwealth-Colonial Group	$51.3b	St George Group	$37.1b
5	ING-ANZ Group	$50.2b	Macquarie Bank Group	$45.3b	ING-ANZ Group	$32.9b
6	Vanguard Investments Ltd	$49.1b	ING-ANZ Group	$44.0b	Commonwealth-Colonial Group	$32.5b
7	BT-Westpac Group	$37.6b	AXA Group	$37.1b	AXA Group	$26.7b
8	Barclays Global investors Australia	$35.7b	Aviva-Navigator	$15.9b	Macquarie Bank Group	$24.4b
9	Perpetual Ltd	$27.6b	Mercer Investment Nominees Ltd	$15.1b	Aviva-Navigator	$16.6b
10	Russell Investment Management Ltd	$21.6b	Australian Wealth Management Ltd	$12.8b	Mercer Investment Nominees Ltd	$13.1b
Top 10 Total		**$518.8b**		**$393.4b**		**$332.6b**
Industry Total		**$952.0b**		**$465.8b**		**$362.2b**

Source: Morningstar, Market Share Report, September Quarter 2008.

[12] We note that since this data was compiled, NAB has announced a purchase of Aviva Australia, which may increase its share of the platform market.

B How are investment products distributed to retail investors?

Main methods of distribution

17 The financial services industry distributes investment products to retail investors in many different ways. In general, the distribution methods for investment products can be simplified into the following three broad categories:

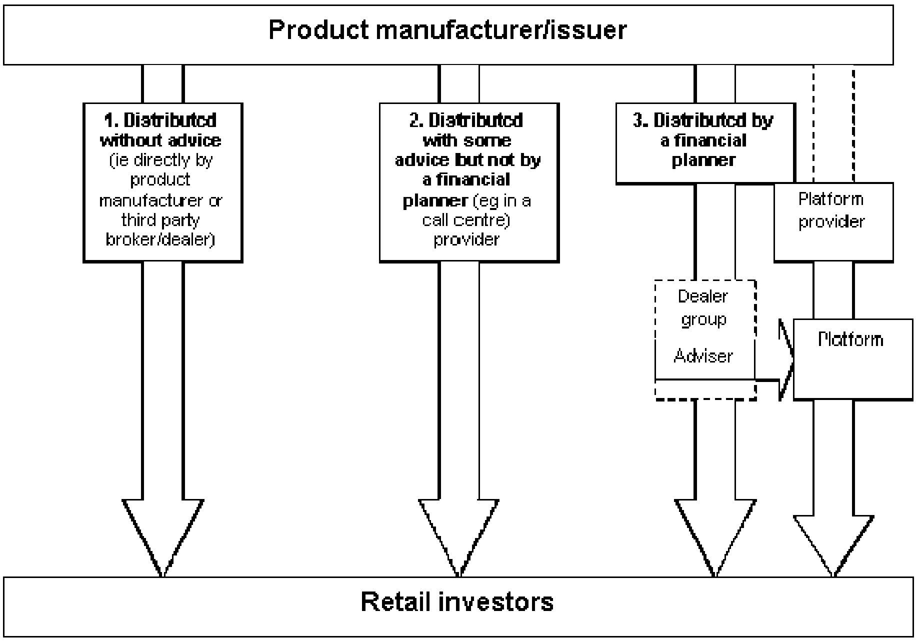
(a) **Distributed without advice** i.e. distributed directly by the product manufacturer or through a third party broker or dealer;

(b) **Distributed with some advice, but not by a financial planner** i.e. distributed by a representative of the product manufacturer who provides some general advice about the product (without considering the investor's personal circumstances) or who provides some personal advice but only about the specific product to be sold or issued to the investor; and

(c) **Distributed by a financial planner** i.e. distributed through a financial planner who provides personal advice to retail clients. The planner may or may not be tied to the product manufacturer, but is likely to receive commissions from the product manufacturer.

As set out below in paragraph 31, financial planners generally use platforms to invest in financial products on behalf of their clients. Figure 4 illustrates the main methods of distribution.

Figure 4: Main distribution pipelines



Shares

18 A significant proportion of retail investors acquire their shares passively e.g. through company distributions and employee share ownership schemes. According to the Roy Morgan ASIC Investor Research, around one third of holders of shares obtain their shares without direct applications to purchase directly. Those retail investors who make an active decision to acquire shares on the secondary market generally do so through a stockbroker, either an online broker or a full service broker. Investors also purchase shares through Initial Public Offerings.

19 The Roy Morgan ASIC Investor Research also found that only around 15% of retail investors get advice about purchasing shares from financial planners.

Debt securities (including debentures)

20 Most issuers of unlisted, unrated debentures market their products directly at their place of business, on their website, or through direct advertising.

21 Generally speaking, few unlisted, unrated debenture issuers rely on financial planners to market their debentures, although the few that do tend to have relatively more debentures on issue than other issuers (e.g. Westpoint). Listed debentures are more likely to be marketed through financial planners.

Managed funds (other than superannuation)

22 The majority of funds placed by retail investors in managed funds come from financial planners, via platforms.

23 The channels used to obtain managed funds in September 2008 were: financial planner/adviser, 54% (tied 34% / not tied 20%); directly through financial institutions, 20%; accountants, 8%; and employers, 3%.[13]

Platforms

What are platforms?

24 A platform is an administration facility that simplifies acquisition and management of a portfolio of investments.

25 Platforms allow retail investors to purchase a range of investments through the one facility. In one sense platforms are like a department store where you can choose from different brand names and products in the one place, rather than having to visit a number of specialty stores.[14]

26 Retail investors are generally put into platforms by their financial planner. The main advantage to planners is that the platform consolidates the reporting on each of the client's investments and makes it more efficient for the planner to monitor their client's portfolio.

27 As investors' funds are pooled together in platforms, they are also effectively buying in bulk, enabling them to increase their buying power and gain access to products normally sold to wholesale investors and at prices normally reserved for wholesale buyers. For example, wholesale funds generally require a minimum investment of $500,000, which usually puts them beyond the reach of a retail investor. However, where many retail investors' funds are pooled in a platform, they can access these products at a wholesale price.

28 A platform provider charges fees for providing the platform service to the investor. The investor will also pay the relevant fee for the investments they choose on the platform. These fees are deducted from the client's investment.

> Note: The fees structure for platforms and managed funds more generally is discussed in Section C.

[13] Roy Morgan Research 2009, *Superannuation and Wealth Management in Australia* p.15.
[14] Commsec uses this analogy to explain platforms on its website: <https://funds.comsec.com.au/Public/Platforms/WhatIsAPlatform.aspx>

29 The two most common types of platforms are:

(a) **master trusts** – a master trust operates as a managed investment scheme. In a master trust the platform operator (or trustee) owns all the assets and the investors hold units in the managed investment scheme; and

(b) **wrap accounts** – a wrap account allows the investor to set up a portfolio of investments where the investment is made in the name of the wrap account operator (or custodian) but the investor has a specific beneficial interest in the assets reflected in the records of the wrap account operator (or custodian). This structure is increasing in popularity. The service 'wraps' or combines investments into a single account.

Note: The use of terminology in this area is not always consistent. The terms 'platforms', 'investor directed portfolio services' (IDPS), 'master trusts' and 'wraps' are often used interchangeably.

Significant proportion of retail investment through platforms

30 A substantial amount of retail investment is made through platforms. Around $55.2 billion of funds are under administration in wrap accounts, around $43.9 billion in investment master trusts, around $191.2 billion in superannuation master trusts and around $70.0 billion in allocated pension master trusts.[15]

31 In 2008, approximately 78% of new investments placed by financial planners was through platforms.[16]

[15] Morningstar, *Market Share Report*, September Quarter 2008.
[16] Investment Trends, 2008 *Planner Technology Report*.

C Fees paid by retail investors

32 Retail investors pay a variety of fees when they acquire investment products. Using managed funds as an example; this section sets out the different sorts of fees that retail investors may pay and how these fees are paid to different financial services providers.

33 In general for managed funds, retail investors tend to pay the same total amount in product fees regardless of whether the product is distributed through a financial planner or directly. Distribution through a platform will involve extra fees for the administration of the platform. Platforms also allow investors to purchase investments at wholesale prices, although this discount in the cost of the product may not be enough to offset the additional fees for administration.

How fees are paid

34 Generally a retail investor acquiring an interest in a managed fund will make an initial investment in the fund. They may also make subsequent contributions to the investment. Different fees are then deducted from this investment, including entry and contribution fees, administration or account fees, transaction fees and fund management fees (investment and performance fees). Fees are generally set by the product manufacturer and built into the product.

35 Each financial services provider (e.g. product manufacturer, financial planner) involved in the investment then gets a payment from these fees for services they provide to the retail investor.

36 That is:

(a) The **product manufacturer** (e.g. fund manager) is paid its fund management fees for managing the investment.

(b) Where there is a financial planner, **the planner and dealer group** are also paid for their advice/sale of the product.

(i) The product manufacturer may pay the planner a commission for the sale of a product and it generally pays this commission through the dealer group. All or part of the commission is then passed on to the individual planner. (Some employee planners receive a salary only so they will not directly receive part of the commission for a sale, although the sale may count towards sales targets that may earn the planner a bonus.)

(ii) The planner or dealer group is also generally paid an ongoing commission (trail commission) and this is paid out of the administration fees charged from the retail investor's account.

37 All investors are generally charged the same product fees, but some proportion of these fees may be rebated to the investor depending on the planner remuneration agreed between the planner and the client. Where an adviser charges fee for service, the planner would generally rebate their share of the product fees back to the client. In theory the retail investor and planner can negotiate the remuneration, although we understand that most investors are generally charged the maximum.

Investing through a platform

38 Platform fees can cost up to 2 to 3% annually of the value of funds invested (around 4% when planner fees are included).[17] But this varies, and average fees would be much lower.

39 Retail investors generally pay the different types of fees in Table 2 below to access investment products through platforms.

Table 2: Fees associated with accessing investments through platforms[18]

Fee	Details
Entry or contribution fees	Up to 5% of initial or subsequent investment value. Entry or contribution fees can be negotiable. The fees are often included in the entry fees paid to planners.
Trail commissions	Around 0.5-1% of investment paid annually by the platform company to the financial planner.
Administration or account fees	Charged by the platform provider to administer the account.
Fund management fees (investment fees and performance fees)	Paid to underlying investment funds (may be included in platform administration or ongoing fee). Wholesale funds available through platforms usually have annual fees of around 0.5-1%.
Planner service fees	0-2% of investment paid to planners. These fees are negotiable with the planners and are debited each month from platform accounts. Planner service fees may be in addition to other ongoing fees.

[17] Choice March 2008, *Wraps & master trusts: What are the fees?* (online) - http://www.choice.com.au/viewArticle.aspx?id=104561&catId=100268&tid=100008&p=5&title=Wraps+%26+master+trusts

[18] Ibid

40 Where there is a platform:

(a) The **platform provider** will deduct its fee for providing administration services from the entry fees and administration fees for the investment and from the contribution fees for each subsequent contribution.

(b) The platform provider will generally pass on the product fees to the **product manufacturer** from the fees paid by the retail investor. The product manufacturer charges fund management fees (investment fees and performance fees based on the performance of the investment) that are also ultimately paid by the investor. The product manufacturer might rebate some of these fees to the platform provider as 'shelf fees' for including the product in the platform. Some of these fees may also be rebated to the dealer group and the investor. These amounts are not usually shared with the financial planner.

(c) If an investor does not use a planner, the platform provider typically retains the proportion of the fees that would otherwise have been paid to the planner. This means that investing directly in a platform may cost as much as investing via a planner.

(d) The **dealer group** might also be paid a volume bonus for having a large amount of funds under management with a particular platform. These fees are again taken from the administration fee paid by the investor.

(e) The **dealer group/ planner** might also be paid a separate planner service fee, which is in addition to the other ongoing fee and may be a flat fee or a percentage-based fee.

D Links between product manufacturers, planners and platform providers

41 There are significant links between product manufacturers, financial planners and platform providers.

42 Most large financial planning firms (i.e. dealer groups) are owned by diversified financial services groups that also include funds management entities (i.e. product manufacturers). Table 3 in Appendix 2 lists selected financial planning dealer groups that rank among the 100 largest in Australia, grouped by ultimate owner, and their related funds management entities.

43 It is common practice for financial planning firms in these groups to receive a significant proportion of their revenue in the form of fees and commissions from related product manufacturers. According to ASIC research, some financial planning firms receive over 75% of their revenue from related product manufacturers.

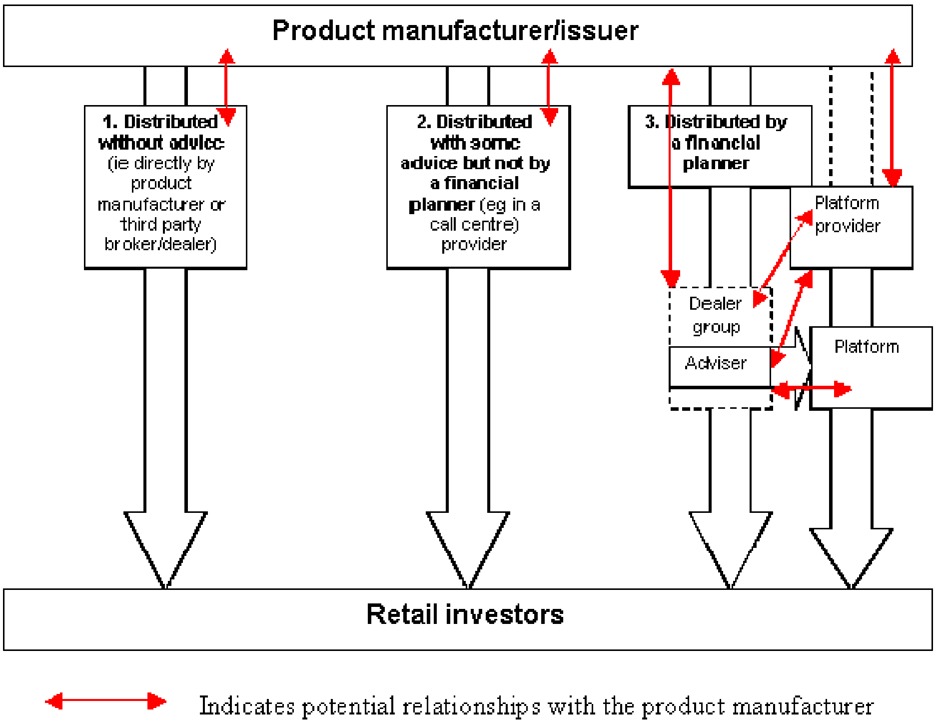
44 There are also links between platform providers and diversified financial institutions (which include dealer groups and product manufacturers): for example see Table 1 which shows that most of the top 10 fund managers are related to the top 10 platform providers.

45 Large diversified financial institutions often own their own platforms and may have an 'in-house' branded platform and allow other institutions to use the same platforms with other branding.

46 Platform providers also may charge product manufacturers fees to have their fund on the platform (or to cover the administrative cost of researching the fund). These are called shelf fees.

47 Figure 5 illustrates the possible links between the distribution channels and the product manufacturers. Clearly not all distribution channels are linked to product manufacturers. Figure 5 merely shows where these links can exist.

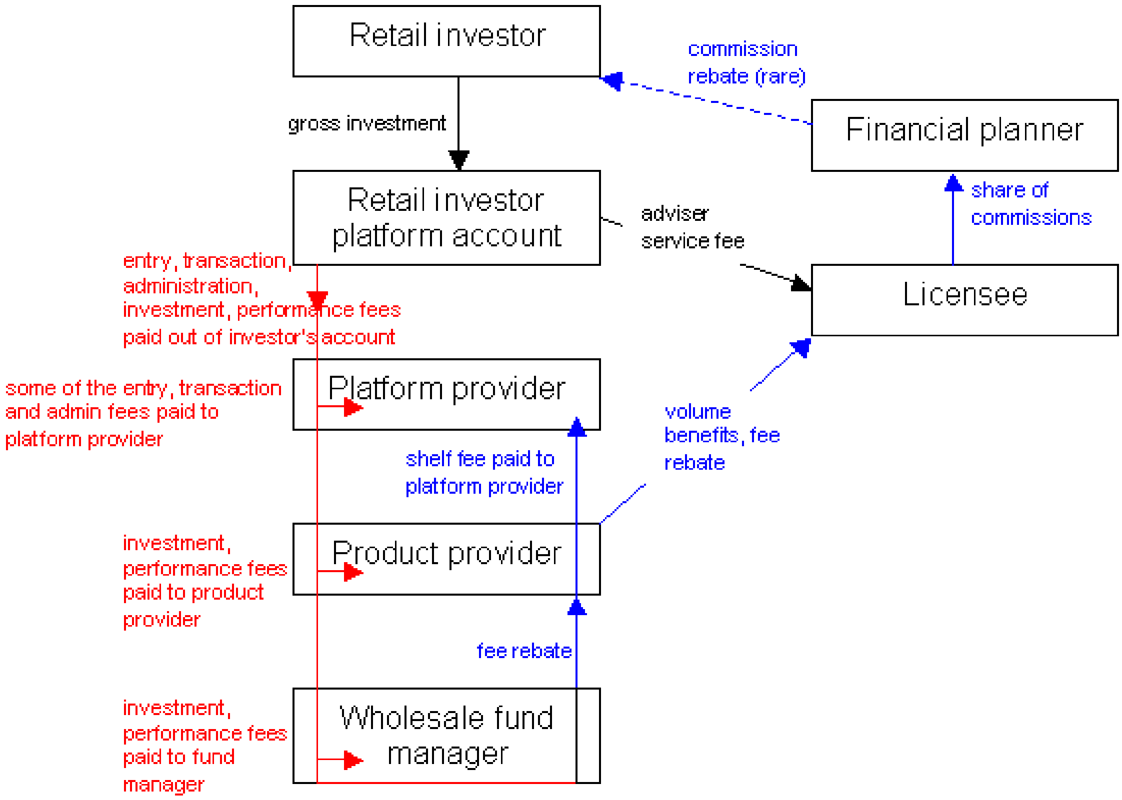
Figure 5: Possible links between distribution channels and product manufacturers



Appendix 1: Diagram showing typical fee flows resulting from the use of platforms

48 Figure 6 below illustrates how the fees flow from the investor down to each party in the chain of the planner, Australian financial services licensee (or dealer group), platform provider and product manufacturer. The commissions flow back up the chain (indicated in blue), for services provided to the retail investor, by each party in the chain.

Figure 6: Typical fee flows resulting from the use of platforms



Appendix 2: Links between financial services groups, financial planning dealer groups and funds management entities

49 Table 3 lists selected financial planning dealer groups which rank among the 100 largest in Australia, grouped by ultimate owner, and their related funds management entities.

Table 3: Selected financial services groups: Links to financial planning dealer groups and funds management entities

Group	Financial planning licensees	Funds management entities
AMP	AMP Financial Planning Hillross Financial Services	AMP Capital Investors AMP Life AMP Superannuation
Australia and New Zealand Banking Group	Australia and New Zealand Banking Group (T/A ANZ Financial Planning)	ANZ Specialist Asset Management ANZ Trustees
Axa Asia Pacific Holdings	Axa Financial Planning Charter Financial Planning Genesys Wealth Advisers Ipac Securities	Ipac Asset Management National Mutual Funds Management National Mutual Life Association of Australasia NMMT NM Superannuation
Bendigo and Adelaide Bank	Bendigo Financial Planning	Adelaide Managed Funds Sandhurst Trustees
Commonwealth Bank of Australia	Commonwealth Financial Planning Financial Wisdom St Andrew's Wealth Management Whittaker MacNaught	BWA Management Investments CFS Managed Property Colonial First State Investments Colonial Mutual Life Assurance Society Colonial Mutual Superannuation Commonwealth Custodial Services Commonwealth Managed Investments St Andrew's Life Insurance St Andrew's Superannuation Services

Group	Financial planning licensees	Funds management entities
ING Australia	ING Financial Planning Millennium 3 Financial Services RetireInvest Tandem Financial Advice	ING Custodians ING Funds Management ING Investment Management ING Life ING Management
IOOF Holdings	Bridges Financial Services Consultum Financial Advisers SMF Wealth Management Wealth Managers	Australian Executor Trustees Intech Fiduciaries IOOF Global One IOOF Investment Management IOOF Life Questor Financial Services
Macquarie Group	Lachlan Wealth Management Macquarie Equities	Macquarie Airports Management Macquarie Alternative Assets Management Macquarie Capital Loans Management Macquarie Communications Infrastructure Management Macquarie Countrywide Management Macquarie DDR Management Macquarie Direct Property Management Macquarie Financial Products Management Macquarie Infrastructure Investment Management Macquarie Investment Management Macquarie Investment Services Macquarie Leisure Management Macquarie Life Macquarie Managed Investments Macquarie Media Management Macquarie Office Management Macquarie Pastoral Management Macquarie Private Portfolio Management Macquarie Specialised Asset Management Macquarie Specialised Asset Management 2 MQ Portfolio Management Retirement Villages Group RE

Group	Financial planning licensees	Funds management entities
National Australia Bank	Apogee Financial Planning Godfrey Pembroke GWM Adviser Services (T/A MLC/Garvan Financial Planning) National Australia Bank (T/A NAB Financial Planning)	Antares Managed Investments MLC MLC Investments MLC Lifetime Co MLC Nominees National Australia Trustees
Suncorp–Metway	Suncorp Financial Services	Suncorp Life & Superannuation Suncorp Metway Investment Management Suncorp Portfolio Services Suncorp Superannuation
Tower Australia Group	Pivotal Financial Advisers	Tower Australia Tower Australian Superannuation
Westpac Banking Corp	Magnitude Group Securitor Financial Group St George Bank (T/A St George Financial Planning) Westpac Banking Corp (T/A Westpac Financial Planning)	Advance Asset Management Ascalon Capital Managers Asgard Capital Management BT Funds Management BT Funds Management No 2 BT Investment Management BT Life Hastings Funds Management St George Life Westpac Financial Services Westpac Funds Management Westpac Life Insurance Services Westpac Securities Administration
Zurich Australia	Financial Lifestyle Solutions Lonsdale Financial Group	Zurich Australia Zurich Australian Superannuation Zurich Investment Management

