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Sent: Monday, 21 July 2008 9:05 AM
To: Senator Nick Sherry (senator.sherry@aph.gov.au)
Cc: bruce.baker@puzzlefinancialadvice.com.au; Shane May (shane.may@treasury.gov.au); Michael Lim (michael.lim@treasury.gov.au)
Subject: How to reduce fees on the $1.3 trillion of Superannuation accounts
Attachments: 080709 AFR Sherry targets shakeup on fees & charges.pdf

Dear Sir

The 9/7/08 AFR discusses your interest in reducing overall fees on superannuation.

Please find below some thoughts on this topic. I think the issues come down to a few themes:
- Increased Competition
- Greater choice in advice
- Shorter & more pointed disclosure documents.
- Greater consumer control over commissions.
- Designing lower cost superannuation service delivery channels

1. Shorter & more pointed disclosure documents.
I have a very strong sense that you are heading in the right direction.
- Shorter PDS – more readable for consumers but does not reduce overall cost very much
- Shorter advice documents that pass the Bernie pub test – this should flow through into less expensive advice choices:
    - Eg advisors who charge for their time will, be able to pass on the cost savings directly.
    - If implemented well, it should also make it viable for some advisor practices to focus on producing low-cost volume-advice for investors with smaller amounts of funds.
    - Impacts like the above, through competition will help add to the growing downward pressure on fees.

2. Put the consumer more in control.
- Outlaw funds that do not allow trailing brokerage to be wound back to NIL – and where the investor instructs the fund manager to rebate the brokerage to the investor, the fund manager must be required to do so, effective the date the instruction is received by the fund manager. This needs to be implemented for all existing investments as well as for all fufture investments. Benefits of this appraoch are:
    - That it puts the onus on the adviser to provide a service consistent in value with the amount of perceived value being received by the consumer.
    - That if trailing brokerage was being charged, and the consumer did not recognise this at the time of investment (as I suspect often happens), the consumer can immediately rectify this.
    - That if the consumer had accepted that it was "just normal that the adviser would receive the trailing commission" and the consumer later realises that there was choice, the consumer can then rectify this.
    - That if the consumer had not been getting any service for years after they last saw the adviser (as often seems to happen) THEN the consumer can have the trailing brokerage rebated – to rectify the situation.
    - That advisers cannot hide behind the excuse that "… but I cannot rebate that trailing commission to you."
    - It would make it much easier (making it viable) for advisers who want to be totally free of the commission system to do so. This would be a very big PLUS as it would help a small (but growing) very important advisor segment to properly emerge – ones who could clearly claim the title of INDEPENDENT as defined under Corporations Law and as interpretted by ASIC. Today, it is very difficult to avoid all trailing commissions – AND it is not cost-effective to rebate to the precise cent, the total amounts of small trailing commission as currently required by ASIC. The emergence of a significant sector of advisors able to clearly display the label INDEPENDENT

would be very important for consumers.

3. Designing some lower-cost superannuation service delivery channels.

- **Option 1 – very basic level superannuation services** through very low-cost channels. (eg H&R Block for Superannuation)
    - There a a number of very low-cost narrowly-focused channels providing tax return preparation services for PAYG taxpayes. A similar or the same concept could be applied to simple narrowly focused superannuation servics. Some examples of the low-cost tax-return service providers are H&R Block and Income Tax Professionals (ITP) eg I saw one operating at the shopping centre on Saturday offering $95 tax returns –the service was limited to mm & dad simple PAYG tax-payers. There may be some regulatory issues to be worked through with this concept.
- **Option 2 – expanding the proposed Superannuation Clearing House role of the ATO.**
    - The ATO have been introducing its excellent Internet-based e-tax system over the last few years, to make it much easier for tax payers to prepare their tax returns. For many taxpayers, e-tax should enable many tax payers to prepare their tax returns without a tax agent.
    - Maybe a new facility like e-tax could be developed for super. Dealing with a tax-payers super is not quite the same problem as the Super Problem – but the concept of electronic hand-holding of the tax payer with regards to their super can surely be applied to handle the superannuation requirements a lot the simple super situations of many tax payers. The concept might go like this:
        1. The ATO provides the standardised interface service for the e-Super services – for all the simple superannuation services that the volume vanilla services that the mum & dad tax payer needs.
        2. And that all Super Fund providers (excluding SMSFs and SAFs) be required to develop an interface between their superannuation administration systems and the ATO.
        3. i.e. the ATO become the central clearing house for this simple super services.

4. Increased competition.
This needs to occur on a number of levels:

- **Competition between fund managers – to drive down Management Expense Ratios (MERs).**
    - From recollection, Australian MERs are substantially higher than US MERs. Fifteen years ago, this used to be put down to scale. However, as scale of Australian funds management has increased dramatically over the last 15 years, MERs have not reduced in a material way. Why is this? I think it comes down to the following:
        - The big fund managers (the price leaders) who dominate the Australian funds management industry, do not compete on price or product. That is – not very much difference in either product (including performance) or price (MERs). It is like an oligopoly – with the usual features of oligopolies.
        - The big fund managers compete on distribution. Therefore, a way to cause greater competition is to destabilise the distribution strategies of the big fund managers, causing them to have to rely more on competing on price. For example:
            - Making sure none of the MER is used to pay dealers and advisors – or to provide any other financial benefit to dealers and advisors.
            - Making sure that there is clear SoA & FSG disclosure of the relationships between product provider and dealer/adviser. I think you are heading in this path anyhow.
            - Outlaw volume commission bonuses – this would help force fund managers to offer all consumers the same lower price of MER. And it would help support the fund managers who feel that they are being held to ransom to pay these volume commissions. In the same breath you could also outlaw shelf-space fees, marketing support assistance and other “invisible” payments or financial support provided by fund managers to dealers and advisors. This is not advocating banning commissions – just ensuring that if financial payments and financial assistance was being paid, that it get paid as up-front and ongoing commissions that consumers have a reasonable chance of understanding. If the consumer has a reasonable chance of understanding the payments, the consumer has a better chance of understanding how these payments might taint the advice that might be provided.
            - There are a range of other measures that could be taken.
    - Make it easy for Australian investors to use American mutual funds which have much lower MERs. This could have a big impact on reducing overall cost of fees on Australian superannuation accounts.
    - Make it easier for Australian investors to access listed US securities. Among other things, there are huge numbers of Exchange Traded Funds (ETFs) listed on US stock exchanges. Many of these ETFs are a good substitute for Australian managed funds – and ETFs tend to have very low MERs. This could have a big impact on reducing overall cost of fees on Australian superannuation accounts.
- **Greater competition between advice segments.**
    - At the edges where accountants and financial planners advice overlaps, allow greater competition.
        - Eg allow accountants greater flexibility to provide planning advice around self-managed super funds – as long as they stay within their areas of competence. Consumer protection obviously is important.

    - Eg allow financial planners greater flexibility to give tax planning advice - as long as they stay within their areas of competence. Consumer protection obviously is important.

- **Greater competition between dealers and advisors.**
    - Make it easier for experienced advisors to get their own AFS Licence.

Best Regards

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