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Dear Ms Neilson

Consultation Paper 308

Thank you for giving us the opportunity to provide this submission on ASIC Consultation Paper 308 (**CP 308**).

We wish to commend you on the excellent proposals presented in CP 308. In our view, most of the proposals should serve to improve the ability of consumers to understand the fees and costs associated with products, as well as enable consumers to compare the fees and costs across different products. At the same time, many of the proposals should also be practicable for industry to implement. Some aspects of the final fees and costs disclosure requirements could, however, present difficulty for compliance, with very little corresponding benefit to a consumer.

Most of our submissions pertain to transactional and operational costs. In summary our main submissions are as follows:

1. Transaction costs should not be included in the "Fees and costs summary" table.
2. There should be no requirement for a product disclosure statement (**PDS**) to include a statement to the effect that transactional and operational costs are an additional cost to an investor.
3. Further consultation should be made before including counterparty spreads in the definition of "transaction costs".
4. The rules governing the calculation of the cost of a derivative should be simplified.

Where transaction costs are to be disclosed in a PDS

Requiring a net amount of transaction costs to be disclosed in the "Fees and costs summary" table creates a risk that consumers will be misled about the nature of these costs. Without further explanation about these costs, consumers may understand that they would not incur them if they invested in the underlying assets directly. They may also not understand that higher transaction costs may actually be beneficial insofar as higher transaction costs could mean that the assets of the pooled investment vehicle have been more actively managed with a view to obtaining better returns. This is crucial information that consumers should be told, and they should be told this information on the same page of the PDS and in the same place as that which discloses the amount of the transaction costs.

Transaction costs are unlike a management fee paid to an investment manager, responsible entity, administrator or custodian of a pooled investment vehicle. These fees paid to parties involved in the operation of the pooled investment vehicle are incurred by virtue of the existence of the vehicle; they are necessarily an additional cost to an investor in that vehicle. If the investor invested in the underlying assets directly, they would not incur the management fees, administration fees or custodian fees, but they would incur the transaction costs. In fact, an investor is likely to incur much larger transaction costs if they invested in the underlying asset directly (assuming it were possible to do). This is because investment managers and responsible entities are much more likely to be able to negotiate lower costs than an individual investor who is not in the business of investing and makes far fewer investments.

While we understand the difficulties with including past performance in a PDS and keeping that information up to date, there is merit in consumers being informed that transaction costs should be considered in conjunction with the performance of the product. Including the amount of transaction costs in the "Fees and costs details" section of the PDS means that this communication could be conveyed in exactly the same place that the amount of the transaction cost is disclosed. The same could not be achieved if the amount of the transaction costs were to be disclosed in the "Fees and costs summary" which must, necessarily, be clear of extraneous information if it is to be effective and serve its purpose of providing an easy comparison. This ease of comparison is primarily important for the additional costs that an investor will incur by virtue of the pooled vehicle; not those costs that it will incur regardless of whether it invests through the pooled vehicle or directly.

In our view, consumers are likely to find the term "net transaction costs" confusing; they are unlikely to know that it means that these are the transaction costs that are not recovered by a buy/sell spread. Providing this explanation in the "Fees and costs details" section is unlikely to elucidate investors. The amount of the "net transaction costs" should be disclosed in the part of PDS where an explanation of the word "net" can be provided. This is another reason why transaction costs should not be disclosed in the "Fees and costs summary" table.

The "Fees and costs details" in a PDS should not be required to disclose a combined total of the net transaction costs and the buy/sell spread. Consumer are likely to understand this as being an additional, separate cost to the other transaction costs, not a composite of the two other transaction costs that are already disclosed.

We agree with the buy/sell spread being disclosed in the "Fees and costs summary" table. Although this is an estimate of the part of transaction costs that will be incurred in converting cash into underlying assets and vice versa, a buy/sell spread is an immediate cost reflected in the value of the product being acquired or sold by the investor. In that sense, it is a more immediate and direct cost incurred by an investor.

A PDS should not state that transitional and operational costs are an additional cost to an investor

Sub-paragraph (j)(iv) of item 209 in Schedule 10 of the Corporations Regulations currently requires the "Additional explanation of fees and costs" section of a PDS to include a statement that transactional and operational costs is an additional cost to the investor. Similarly, CP 308 proposes that the revised Schedule 10 require that the "Fees and costs details" section of a PDS to include a statement that transaction costs are an additional cost to the investor where the cost has not already been recovered by the buy/sell spread charged by the operator of the pooled investment vehicle. We disagree with this proposal. This statement could be interpreted in several ways. If there is to be a requirement for a PDS to include a statement to this effect, the statement should make clear that it is not additional in the sense that an investor would not incur the cost if the investor invested in the underlying asset directly.

Counterparty spreads - further consultation required

CP 308 cites ASIC Report 581 (the report prepared by Mr Darren McShane) as the basis for the proposal that counterparty spreads be included in transaction costs that are to be disclosed in a PDS and periodic statements. Without detracting from the excellent and extensive work that Mr McShane's report represents, we question whether further consideration in relation to the subject of counterparty spreads is not justified before implementing a reform based on the rationale set out in Report 581. Mr McShane refers to "quote driven markets" and "regulated markets" without providing an explanation of the meaning of these terms. While they seem to occupy mutually exclusive categories in Report 581, it is not entirely clear that this is, in fact, the case. Mr McShane's consideration of these terms is used largely in the context of foreign jurisdictions. The Corporations Act and some ASIC forms use different terms to refer to markets; these include "financial market" and "licensed market".

Imposing regulatory obligations in relation to calculating and disclosing counterparty spreads is likely to impose a substantial burden on financial services providers. Before such a burden is imposed, the key terms used in the underlying policy rationale should be clearly understood.

Rules pertaining to the cost of derivatives

CP 308 proposes to maintain the current requirements for the treatment of costs associated with derivative financial products as indirect costs and to include certain other costs associated with derivative financial products as transaction costs.

We submit that the treatment of the costs associated with derivative financial products should be simplified. The complexity of the current rules governing the calculation of these costs and the cost of complying with these rules far outweighs the benefit or protection given to a consumer. In our view, these rules could be simplified so that the cost of the derivative need only be calculated and disclosed for total return swaps or other similar derivatives where a reasonable person would determine that they were being used to avoid having to disclose a fee or cost. While we acknowledge that there is an element of subjectivity to such a general rule, the outcome is likely to be just as effective from a consumer's perspective and much less costly to a product issuer.

Thank you again for the opportunity to make these submissions. We look forward to having the opportunity to provide further input into the fee disclosure requirements.

Yours sincerely

Johnson Winter & Slattery