



Retail Registered Schemes
Fees and Charges
Second Release

July 2002

This report contains 12 pages

Appendices contain 4 pages

IFSA02A-Finalreport-RO407-LCB

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1 Executive summary

This report has been prepared by KPMG who were engaged by IFSA to conduct an analysis of the levels and trends in fees and charges an investor incurs through investing in retail registered managed investment schemes (“retail schemes”) for the period from 1996 to 2001.

Our study identified the fees and charges incurred by an investor for distribution (entry), investment management and administration.

With respect to distribution fees we noted there exists a large variety of structures available to the investor. Whilst the data available did not permit a quantitative analysis to be performed over distribution fees we conclude that over the past six years the potential cost to an investor of entering a scheme has reduced through both an overall reduction in the level of up front fees from a range of 4% to 5% to a range today of 0% to 5% and the evolution of low cost distribution channels such as discount brokers.

Fees for investment management and administration are bundled and included as part of the registered scheme’s MER. For the period 1996 to 2001 we found there has been an overall reduction in the weighted average MER of 4.6% (or seven basis points). This seven basis point decrease in MER translates to a cost saving for investors of approximately \$71.7m in 2001.

During the period of our study there were two significant regulatory developments impacting retail schemes. These developments were the implementation of the Managed Investments Act (MIA) from 1 July 1998 and the introduction of Goods and Services Tax (GST) on 1 July 2000.

Our analysis found that in the period following the implementation of the Managed Investments Act there has been a four basis point reduction in MER. This reduction can be represented as producing a saving in fees for investors in 2000 and 2001 of \$35.7m and \$41.0m respectively.

Notwithstanding the predicted increase in MER caused by the introduction of GST our research study found that for the period following the introduction of the GST (ie. 2000 to 2001) the total weighted average MER declined by one basis point (0.68%). This reduction in MER translated in further cost savings to investors of approximately \$10.2m in 2001.

2 Research background

2.1.1 Overview

This report has been prepared by KPMG who were engaged by IFSA to conduct an analysis of the levels and trends in fees and charges an investor incurs through investing in retail registered managed investment schemes (“retail schemes”).

This report presents the results of our study undertaken in conjunction with IFSA to:

- identify the fees and charges paid by an investor of a retail scheme; and
- report on the trends in these fees and charges from the period from 1996 to 2001.

Our findings for the period 1996 to 2000 were released in August 2001. This report represents an extension of our analysis to the 2001 year. The updated data is included in section 4.3.1.

2.1.2 Products selected

Our analysis of retail schemes was undertaken on the basis of asset class. The following core asset classes were separately identified and analysed:

- domestic equity (both active and passive management)
- international equity
- cash
- domestic bond
- international bond; and
- diversified funds.

With respect to diversified funds, three categories were separately analysed using ASSIRT criteria. These categories were:

- Multi-sector 30 – Diversified income funds;
- Multi-sector 70 – Diversified balanced funds; and
- Multi-sector 70+ – Diversified growth funds.

For all asset classes selected, with the exception of international and domestic bond, KPMG were able to obtain data for products, which in aggregate covered between 75-80% of the FUM¹ of that particular class². For the domestic and international bond asset classes, the data obtained represented 50% of FUM¹ for their respective class.

¹ Using FUM per ASSIRT Market Share Report – December Quarter 2001.

2.1.3 Sources of data

In accordance with IFSA directives KPMG did not conduct surveys of IFSA members during our data collection process. Data was acquired through researching publicly available information over the past six years. Publicly available information researched included prospectuses and individual retail scheme financial statements.

2.1.4 Time horizon

Our analysis of retail schemes covered the six year period from 1996 to 2001.

2.1.5 Disclaimer

The statements and analysis in this report are provided in good faith but rely upon the information obtained from the sources identified in this report. The report also draws upon the resources of KPMG.

KPMG does not have any pecuniary interest that could reasonably be regarded as being capable of affecting their ability to give an unbiased opinion in relation to the matters researched in this report.

KPMG will receive a professional fee for the preparation of this report.

² Not all asset classes incorporated in the ASSIRT data were included in the survey.

3 Overview of all fees and charges

As is shown by the following diagram consumers are charged fees for the following services:

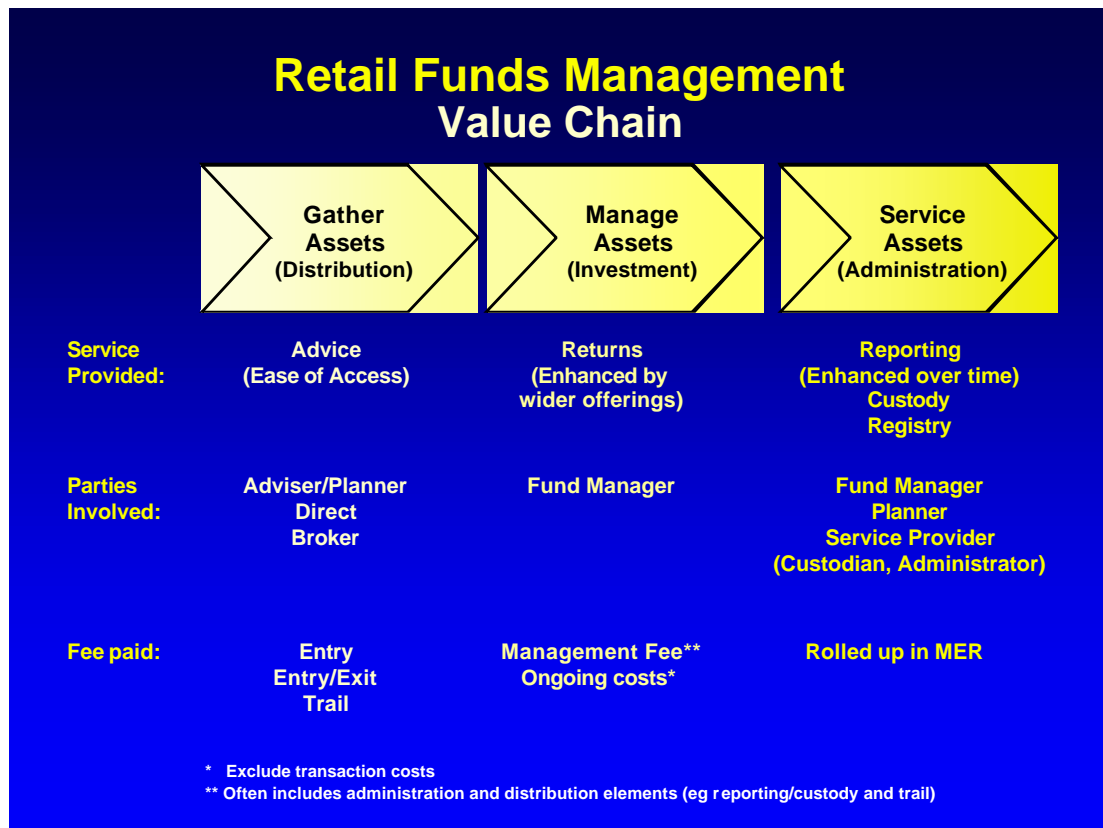
- distribution;
- investment management; and
- administration.

The level of total fees that a consumer pays is dependent upon the method of distribution, investment management and scope of service that the consumer or their product demands.

It is also relevant to note that fees are received by more than one participant in the managed investments value chain.

The following diagram illustrates the nature of fees charged for each product and services offered and identifies the parties involved.

The products and services provided may be sourced either from within the one organisation or from different organisations.



3.1.1 Distribution

Distribution fees are paid to the party which introduces the investor to the scheme (eg financial planner, discount broker, etc).

Distribution fees are applied in one of two ways:

- up-front fees: or
- on-going (“trail”) fees.

Up-front fees are levied once only at the date the initial investment is made. Trail fees are applied during the term of the investment.

An alternative to an upfront fee may be to charge an exit fee should the investor withdraw from the product within a specified time. The exit fee is stepped to reduce to nil over time, should the investor remain in the fund for greater than the specified time.

3.1.2 Investment management

Investment management fees are paid to the party which manages or invests the scheme property. The fees incurred for investment management are included as part of a scheme’s management expense ratio (“MER”).

The IFSA definition of MER and its inclusions is contained in Appendix 1. These fees are calculated as a percentage of the scheme’s net assets and are quoted in annualised terms. The MER excludes all up-front and exit fees.

3.1.3 Administration

In the case of retail schemes, the cost of administration services is generally included in the scheme’s MER, irrespective of which party provides the service.

4 Retail schemes

4.1 Overview

The fees and charges paid by an investor in a retail scheme for distribution, investment management and administration are embodied in the entry fee and the MER.

As outlined below, depending upon the election made by the investor, entry fees may be paid separately at the time of initial investment or “wrapped up” in the MER. Fees for investment management are included in the MER. In addition, the cost of administering a retail scheme is generally bundled and included in the MER without separate disclosure to the investor.

4.2 Distribution

Investors pay a fee for distribution when initially investing in a retail scheme. This fee can be paid through one of two options:

- up-front fee levied on the initial investment; or
- on-going fee levied over the life of the investment.

Historically, the most common manner of entry for an investor into a retail scheme has been via a financial adviser. The service provided at this time was generally paid “up-front” by the investor, based either on the time and expertise involved in the advice provided (“fee for service”) or on the value of the investment (“up-front fee”).

More recently, fee structures have been amended to provide investors and advisers with the option to lower (to nil in many instances), up front entry fees and to replace this with a trail over the life of the investment. Where this “dial up” option is utilised the investor will usually incur a higher MER than an investor that has elected an entry fee option. The difference between the MER’s in each case approximates the fee paid for distribution.

Where this alternative has been made available, the trail fee has been in the range of 0.33% to 0.60%, with the average being 0.44%.

The payment of a trail by the manager of a scheme to an adviser/broker may also take place without an election being made by the investor. In these instances the manager bears the cost of the trail, without a corresponding increase in the MER. This scenario has become increasingly evident with the evolution of new distribution channels, such as discount brokers.

4.2.1 Historical trends

The data which is publicly available provides a guide as to the range of fees paid by an investor as a result of their entry to a scheme. What is actually paid by an investor cannot be determined from these sources as, for example:

- up-front fees may be rebated;
- an adviser's fee for service will vary from situation to situation;
- where offered the combination of entry fee and trail will vary from investor to investor.

The types and structure of the various fee options which are available to a retail investor are summarised in the following table.

Method of distribution	Type of fee	Levy base	Term of fee	Distribution fee paid by	Range of fee
Financial adviser	Fee for service	Time	Provision of advice	Investor	Various
	Up-front	Initial investment	Levied once only	Investor	Nil to 5%
	Trail (included in MER)	Investment value	Term of investment	Manager/ Trail may be dialled up by investor	0.33% to 0.60%
Broker	Up-front	Initial investment	Levied once only	Investor	Nil to 5%
	Trail (included in MER)	Investment value	Term of investment	Manager	0.33% to 0.60%
Direct	Up-front	Initial investment	Levied once only	Investor	1% to 5%

We are able to conclude that over the past five years the *potential* cost of entering a scheme has reduced through:

- a reduction in the level of upfront fees which historically were at 4% to 5% and are now quoted in the 0% to 5% range; and
- the evolution of low cost channels such as discount brokers.

4.2.2 Buy/Sell spread

The price at which an investor enters or exits a scheme is usually subject to a buy/sell spread, typically in the range of 0.15% to 0.50%. This spread is designed to meet the costs incurred by the scheme in acquiring or selling investments at the time of entry or exit of an investor to or from the scheme, such that existing and ongoing investors are not disadvantaged. As a consequence, the spread is “retained” within the scheme and is not paid to any party involved in its operation.

4.3 Investment management and administration

The fees an investor pays for investment management and administration are bundled together and included as part of the management expense ratio (MER). KPMG's analysis of investment management and administration fees was performed by reviewing the trend in the MER¹ for retail schemes.

4.3.1 Historical trends

We performed an analysis of the historical trend in the size of the MER¹ from 1996 to 2001 for all core asset classes of retail schemes, the results of which are contained in the following table.

Asset class	Weighted Average MER (%)					
	2001	2000	1999	1998	1997	1996
Domestic equity – active	1.81	1.78	1.81	1.84	1.87	1.88
Domestic equity – passive	1.13	1.15	1.29	N/A	N/A	N/A
International equity	1.91	1.95	2.01	2.02	2.04	2.05
Cash	1.03	1.04	1.06	1.07	1.08	1.08
Domestic bond ²	1.44	1.47	1.46	1.48	1.50	1.60
International bond	1.73	1.74	1.83	1.82	1.84	1.87
Diversified funds – Income	1.51	1.47	1.45	1.48	1.54	1.62
Diversified funds – Balanced	1.88	1.86	1.88	1.92	1.95	2.02
Diversified funds – Growth	1.88	1.85	1.91	1.89	1.96	2.00
Total weighted average MER	1.46	1.47	1.50	1.51	1.53	1.53
Total weighted average MER (ex cash)	1.81	1.81	1.85	1.87	1.89	1.92

¹ To maintain comparability where entry and nil entry fee alternatives were offered which resulted in a different MER for the same product, the entry fee option was used in the analysis.

² Prior year data has been recomputed to ensure comparability with products included in 2001 data.

The total percentage decline in MER by asset class from 1996 to 2001 is detailed in the following table.

Asset class	Basis point decrease	Percent decrease
Domestic equity – active	7	3.7
International equity	14	6.8
Cash	5	4.6
Domestic bond	16	10.0
International bond	14	7.5
Diversified funds – Income	11	6.8
Diversified funds – Balance	14	6.9
Diversified funds – Growth	12	6.0
Total weighted average MER	7	4.6
Total weighted average MER (ex cash)	11	5.7

As noted from the above table the size of the percentage decline in MER from 1996 to 2001 is not consistent across all asset classes.

The results of our analysis indicate that for those asset classes subject to our study the MER decline ranged from 3.7% to 10% from 1996 to 2001.

The total weighted average MER across all asset classes has declined by 4.6% or seven basis points. This seven basis point decrease translates to a cost saving for investors of approximately \$71.7m in 2001.¹

4.3.2 Significant regulatory change during the period of study

4.3.2.1 Introduction of Managed Investments Act (MIA)

The Managed Investment Act amendments became effective on 1 July 1998. However, transitional provisions provided a two year period from this date to register schemes with ASIC.

¹ Based on ASSIRT FUM data as of 31 December 2001

The more significant aspects of the introduction of the MIA were the removal of the trustee's responsibilities with respect to retail unit trusts and their replacement with a more rigorous compliance regime for responsible entities.

Given the two-year transitional provisions associated with MIA, we would expect any impact on fees as a result of MIA to be incorporated in 2000 fee data.

As seen from our data presented at section 4.3.1 the total weighted average MER declined four basis points from 1998 to 2000.

The following table calculates savings received by investors in 2000 and 2001 as a result of this four basis point reduction in total weighted average MER from 1998 to 2001.

Year	MER saving basis point	Investor savings \$m ¹
2000	4	35.7
2001	4	41.0
Total		76.7

Our analysis reflects that for the two-year period following the implementation of MIA there has been a four basis point reduction in MER that translates in total savings to retail scheme investors of \$76.7m.

4.3.2.2 *Goods and Services Tax (GST)*

GST was introduced on 1 July 2000. The goods and services (including the management fee) consumed by a retail scheme are generally subject to GST. Retail schemes are generally permitted to claim a credit of 75% of the GST they incur.

The majority of current prospectus' reviewed disclosed that managers anticipated MER's to increase by approximately 2.5% as a result of the implementation of GST.

Notwithstanding the potential impact of GST on MER's our research study found that the total weighted average MER has declined by one basis point from 2000 to 2001 (or 0.68%). This reduction in MER translates in a total cost saving to investors of approximately \$10.2m² in 2001.

¹ Calculated using retail unit trust FUM as at 31 December 2000 and 31 December 2001 per ASSIRT.

² Calculated using ASSIRT retail unit trust FUM as at 31 December 2001.

The results are summarised in the following table:

	MER		Investor cost/(saving) \$m
	Percent Increase/ (decrease)	Basis point increase/ (decrease) ¹	
Predicted impact of GST	2.5	3	30.7
Actual movement in MER from 2000 to 2001	(0.7)	(1)	(10.2)

¹ Based on total weighted average MER of 1.46 per our results tabulated at section 4.3.1.

A Appendix 1 – MER

IFSA defines the management expense ratio in IFSA Standard 4.00 as:

$$\text{MER} = \left(\frac{\text{Fees} + \text{Recovered expenses} - \text{ITC}}{\text{Average Scheme Size}} \right) \times 100$$

Fees include the following:

- management fee (excluding up-front and exit fees);
- fees of the trustee; and
- other fees which include:
 - local and overseas manager fees;
 - custodian fees;
 - audit fees;
 - trail commissions; and
 - amounts paid to ATO under GST reverse charge provision.

Recovered expenses are expenses incurred by the operation of the scheme, these include:

- transaction costs;
- brokerage;
- repair, maintenance and refurbishment costs;
- GST; and
- Government taxes and charges for transacting on investors account if paid out of the scheme;

But exclude the following expenses:

- Government taxes and charges for purchases and sales of securities (FID and BAD);
- income and other tax (excluding capital gains tax); and
- interest expense on specific borrowings.

ITCs are input tax credits received or receivable from the Australian Taxation Office.

B Appendix 2 – Detailed asset class data

Domestic equity – active	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.81	1.78	1.81	1.84	1.87	1.88
Low	1.70	1.66	1.66	1.73	1.76	1.71
High	2.05	2.00	2.00	2.00	2.00	2.08
Spread	0.35	0.34	0.34	0.27	0.24	0.37

Domestic equity – passive	Weighted average MER		
	2001	2000	1999
Weighted average MER	1.13	1.15	1.29
Low	0.75	0.75	1.15
High	1.28	1.25	1.38
Spread	0.53	0.50	0.23

International equity	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.91	1.95	2.01	2.02	2.04	2.05
Low	1.25	1.50	1.50	1.50	1.50	1.50
High	2.23	2.23	2.36	2.36	2.34	2.40
Spread	0.98	0.73	0.86	0.86	0.84	0.90

Cash	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.03	1.04	1.06	1.07	1.08	1.08
Low	0.84	0.86	0.81	0.83	0.98	0.98
High	1.19	1.19	1.22	1.24	1.20	1.20
Spread	0.35	0.33	0.41	0.41	0.22	0.22

Domestic bond	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.44	1.47	1.46	1.48	1.50	1.60
Low	1.10	1.11	1.12	1.16	1.16	1.25
High	1.78	1.83	1.88	1.88	1.77	1.83
Spread	0.68	0.73	0.76	0.72	0.61	0.58

International bond	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.73	1.74	1.83	1.82	1.84	1.87
Low	1.57	1.50	1.63	1.55	1.60	1.54
High	2.27	2.42	2.35	2.37	1.97	1.94
Spread	0.70	0.92	0.72	0.82	0.37	0.40

Diversified – Income	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.51	1.47	1.45	1.48	1.54	1.62
Low	1.12	1.09	1.12	1.17	1.30	1.44
High	2.04	2.04	2.09	2.06	2.09	2.11
Spread	0.92	0.95	0.97	0.89	0.79	0.67

Diversified – Balanced	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.88	1.86	1.88	1.92	1.95	2.02
Low	1.56	1.60	1.62	1.71	1.83	1.93
High	2.09	2.04	2.09	2.12	2.12	2.22
Spread	0.53	0.44	0.47	0.41	0.29	0.29

Diversified – Growth	Weighted average MER					
	2001	2000	1999	1998	1997	1996
Weighted average MER	1.88	1.85	1.91	1.89	1.96	2.00
Low	1.56	1.54	1.65	1.65	1.63	1.64
High	2.33	2.23	2.25	2.15	2.17	2.23
Spread	0.77	0.69	0.60	0.50	0.54	0.59