Dollar amounts to be disclosed

Problems still remain with the dollar disclosure provisions issued by ASIC.

ASIC has issued a Class Order [CO 04/1176] providing interim relief from the "dollar disclosure provisions" for licensees (and their representatives) and product issuers. The dollar disclosure provisions will require the disclosure of fees, costs, benefits and interests to be disclosed in dollar amounts in Statements of Advice (SOA), Product Disclosure Statements (PDS) and Periodic Statements from 1 March, 2005.

While this interim relief is welcome, it does not address some of the significant practical impediments to dollar disclosure, nor does it recognise the nexus between other initiatives, including the ASIC Fee Model and the Government's single fee measure.

In our submission to ASIC, the Institute highlighted a number of issues, particularly as they relate to stockbrokers and financial advisers. In relation to other sectors of the financial services industry, the Institute has offered our support for submissions made by the Investment and Financial Services Associations (IFSA) and the Australian Bankers' Association (ABA).

Dollar disclosure for derivatives

We believe that it is not possible to disclose dollar amounts for products used to manage a risk, i.e. 'risk management products' (e.g. equity derivatives, commodity derivatives, interest rate derivatives and foreign exchange derivatives). These products are tailored to the individual and contain cost variables, and therefore the net cost cannot be predetermined.

Some elements of the transaction may be known up-front, for example the margin, but even this figure may change throughout the term of the transaction. Other elements of the price will simply not be known up-front: for example, an option premium is based on a number of factors including size and term of the transaction, market volatility, product liquidity and volume of transactions.

Another difficulty with disclosing in dollar amounts up-front is assessing the net cost of hedging a position and how this risk management effect may impact on the cost of the overall transaction.

Therefore, the Institute asserts that it is not reasonable to require derivative products to be disclosed in dollar amounts or percentages in PDS or SOA. We believe that a generic description of the factors and assumptions considered in determining the total price of the product would not compromise the legislative intent by providing investors with adequate disclosure at the point of sale and at the time of advice for investors to make an informed decision.

Worked examples

Another issue is the proposal to include prescribed worked dollar examples. Due to the plethora of cost components and fee structures, we are concerned that worked examples could only ever be illustrative of one likely scenario and therefore could be 'misleading' and ultimately contrary to the interests of a client who places too much reliance on the scenario analysis.

Furthermore, the complexity of some risk management pricing algorithms would vitiate against the obligation under the Corporations Act, to be "clear, concise and effective". Therefore, we consider that where worked examples are adopted, this must be at the discretion of the provider or issuer and there must be an acknowledgement that this disclosure is only an estimate; otherwise, disclosures should only be considered hypothetical. Importantly, the Institute has requested ASIC and industry continue to work together on the matter of worked examples with the aim of delivering improved disclosure outcomes for retail investors.

Brokerage and other remuneration

Like pricing a derivative contract, it is not possible to disclose dollar amounts up-front for the costs associated with trading financial products. There are a number of variables that go to the total cost of brokerage and commission, and therefore the net cost is unknown prior to the trade being executed.

Dollar disclosure at the point an SOA is provided to a retail client is mathematically impossible. We suggest that when an SOA is required that disclosure be provided in percentage terms, indicating the standard range for brokerage or commission. Generic description of other factors, including the possibility of bonus payments, could be outlined simply in tabular form.

The Institute advocates high standards in disclosure as essential for ensuring that investors can compare financial products and financial investments and make an informed decision. We believe that as part of this policy development process, thorough consumer testing should assess how retail investors receive and use information.

Some basic questions that consumer testing should be asking are: Do people understand dollars as a measure? Does dollar disclosure add value for a consumer in being able to assess financial products or compare investment opportunities? Do buying decisions exist only in relation to cost; what about the relationship between price-quality (suitability and risk assessment)? This type of consumer testing in relation to dollar disclosure would contribute towards understanding more generally the role for consumer education on 'fees and charges'. J

At the time of printing, ASIC was due to release its final policy on dollar disclosure the following week.