AndexCharts Pty Ltd.

FAX

To: CFL Taskforce Secretariat
Company: SCGSD - Department of the Treasury
Fax: 02-6263-2830
Date: 2 August 2004
Re: Submission to The Consumer and Financial Literacy Taskforce

Dear Sir/Madam,

I understand the deadline for submissions to the Taskforce was 31 July, but hope you are still able to pass this on for consideration.

Kind regards,

Dave Reid
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Phone: 1800-242-787

AndexCharts Pty Ltd.

CFL Taskforce Secretariat
SCGSD
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Friday 30 July 2004

Dear Sir/Madam,

Having read the discussion paper *Australian Consumers and Money*, I wish to contribute the following feedback to the Taskforce. Without supposing to have all the answers, I hope my experience in the field of investor education can add something of use.

I spent three years working in Toronto for an industry sponsored information service for Canadian mutual fund investors. The service covered a wide variety of issues associated with personal finance and investing with a particular emphasis on managed funds and retirement saving.

Since then I have returned to Australia to set up Andex Charts Pty Ltd., a company which seeks to supply the financial services market with effective tools for investor education. The charts we produce provide financial planners and other investment educators with historical evidence to illustrate a broad range of investment concepts.

Andex is affiliated with a Canadian firm, which produces similar charts for the North American market. Based upon important academic research carried out in the US, our flagship "Andex Chart" maps the performance of key asset classes over several decades. The Andex Chart has been adopted as an industry standard in Canada and is distributed each year by each of the five major Canadian banks and dozens of independent financial planning firms. As a result Andex has played a significant role in the education of Canadian investors.

Both here and in Canada, the financial literacy of most consumers is startlingly inadequate for the successful negotiation of the numerous financial challenges each of us face over the course of a lifetime. Furthermore, I believe Australians are at a greater disadvantage in this regard than are their Canadian counterparts.

The following pages contain a few thoughts and suggestions I hope you will find useful. I am keen to contribute further should any of the following prove particularly interesting and would happily volunteer my time to this project.

Kind regards,

David Reid
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Phone: 1800-242-787

The Legislative Environment

Question 2.1

Economic forces and government intervention can both improve and constrict a consumer's ability to understand and act on information. As such, information providers must make assessments about the extent to which information alone can change consumer behaviour.

Are economic and government factors sufficiently understood by information providers in information provision to consumers?

The patchwork muddle of legislation governing taxation and superannuation is a massive impediment to a consumer's ability to understand and act on information. Taxation and superannuation legislation is so complex in this country that even when an information provider understands every aspect of a problem, there is often little chance this information can be successfully communicated to the consumer. In an era where consumers are being asked to take more responsibility for savings and investment management, legislative complexity denies a great many Australians a reasonable chance of doing so.

Any representation to government should call for a radical overhaul of the tax system, especially where superannuation is concerned. A simplified system could greatly empower Australian consumers, reduce the complexity of many financial products and eliminate the waste in time and energy currently devoted to negotiating the legislative maze that surrounds personal finance.

Benchmarking

Question 2.6

How can we benchmark those skills?

A system for benchmarking financial literacy is perhaps the most powerful outcome the taskforce might produce. Without it we can only guess at where we are, what we need to do and how well we manage to do it.

In devising a system we must consider the points at which financial literacy may be measured. The school system provides an obvious opportunity. As we strive to ensure all school leavers achieve a level of financial literacy, the success or failure of our efforts should be measured by regular testing. Outside school however, the opportunity to canvas broad sections of the community becomes less obvious.

In considering the various "consumer life events" most of us encounter, the Taskforce discussion paper highlights some other points at which we might potentially test financial literacy. These include:

- Opening a bank account
- Getting a credit card
- Buying insurance
- Buying a house
- Getting married
- Investing
- Planning for retirement

As each consumer life event occurs consumers interact with financial intermediaries, government agencies and businesses. These individuals and organisations are increasingly obliged to take some of the responsibility for the outcome of their involvement with consumers. For example the law now requires financial planners to know their clients and understand their clients requirements before offering investment advice.

My company recently surveyed financial planners from around Australia and asked them what percentage of their clients fell into each of the following five categories:

- Very sophisticated investors
- Sophisticated investors
- Neither sophisticated nor unsophisticated investors
- Unsophisticated investors
- Very unsophisticated investors

The problem with such a subjective question is of course, that there is no benchmark against which a financial planner might compare each of his clients. A client deemed sophisticated by one adviser might be deemed unsophisticated by another. I believe financial planners would greatly benefit from a system that accurately gauged the financial literacy of their clients.

A coordinating body might endorse an industry-approved set of questions to be asked of every financial planning client during an initial interview. The questions could be formulated to help ensure the planner was meeting his legal obligations to know his client. The planner might keep a copy of the results, the client might equally be given a copy, while another would be returned to the coordinating body and added to a national database.

The results would help the planner understand the needs of his clients. The aggregate statistics would be useful to a wide range of stakeholders including product providers, consumer advocacy groups, government etc. And this information would be valuable in the market place. Far from producing a drain on the public purse the data could be sold to pay the costs of the coordinating body. Or perhaps the financial services industry would be willing to sponsor a body to carry out this research on behalf of all stakeholders.

Similarly, either on a compulsory or volunteer basis, consumers could be asked a set of questions every time they open a bank account, apply for a credit card, purchase a house or buy a mobile phone. In each case product providers could use the information to help ensure standards of care are upheld. The process could be used to highlight to make clients more aware of gaps in their understanding. And at a national level we would gain an ever-greater insight into our behaviour toward and understanding of financial matters.

Independent Information

Question 2.7

What information sources do consumers trust?

Consumers trust independent information. In my own business I am continually receiving feedback from financial planners who use our charts. On a regular basis planners tell me they use our charts because they come from an independent source. Financial planners know clients instinctively mistrust information that is designed to market a particular product or brand.

With this in mind, the need for an independent an authoritative source of information for consumers is great. The Taskforce could provide, as I understand has already been suggested, a stamp of approval for, and referrals to information providers in the market place. Thereby giving the public a trusted source of accurate information.

Language

Question 2.7

Are consumers confused by different information on the same issue?

The mass media have a profound influence on consumer behaviour, but often only add to the confusion. In a classic example The Australian newspaper recently published a feature article in its "Wealth" supplement titled "Appetite grows for Managed Funds" (Wednesday 23 June 2004). The author of this article describes managed funds as an "asset class" and was so obviously confused by several other basic investment terms as to make her article ridiculous. I would like to quote my favourite sentence, which certainly highlights the challenge for investment educators:

> *...With so many funds available combined with the different styles of managers adopted – that is, value or growth – educating investors about the sector is becoming increasingly difficult.*

Unfortunately, journalists so often produce material like this.

Apart from the fact that many journalists fail to understand their subject before they write about it, this article highlights a need to standardise the language of finance in this country. The government and financial services industry in Australia has done itself and the Australian public a massive disservice by producing a mass of confusing jargon to describe its various products and services.

The Taskforce might look at ways to standardise the language of Australian finance.

COVER STORY

Appetite grows for managed funds

"managed funds" are not an "asset class"!

Money is flowing back into the asset class but managers are being kept on their toes. **Gayle Bryant** reports

MONEY is once again flowing into managed funds but the landscape has changed, with many investors much more savvy about what they want from investments.

In particular, investors no longer accept the excuse of "you're in it for the long term" when returns in their managed funds consistently head south, especially if similar funds are recording positive results. Investors want results for the fees that they pay to advisers and fund managers.

However, confidence has definitely returned to the sector. Rainmaker Information's March 2004 quarterly roundup highlighted a fourth consecutive quarter of positive investment flows into the Australian managed investment market. According to Rainmaker, the Australian managed investment market grew 2.5 per cent in the March quarter, contributing to an annual growth rate of 18 per cent, or $132 billion. At the end of March, the entire market amounted to $864 billion.

It is difficult to keep tabs on such a growing asset class.

Stephen van Eyk, head of investment research house Van Eyk Research, says one of the trends within the managed funds asset class is the movement of managers.

"There have been more than 50 managers of equity funds change over the past couple of years — either moving to another fund, out of the industry or to start their own fund," he says. "There has also been a growth in the number of boutique funds which has spread the talent more thinly. Five years ago I was monitoring 25 managers but now I have 48 to watch — almost double."

Van Eyk says some fund managers start their own fund after doing well with a larger firm and deciding that they want to have a go at running their own. "It is not just the high profile managers that change; there are many senior, experienced managers setting up their own funds," he says. "This talent drain has led to the larger funds hiring talent from overseas. One manager I spoke to recently spent six months looking for a chief information officer."

He says another trend in this industry is that larger fund managers are scrambling to diversify their business.

"For example, traditional international managers are looking around to see what they can add to their mix in case the international markets don't do well," he says.

"The larger Australian equities managers are also

Transparency improves but the

THE AUSTRALIAN Wednesday June 23 2004

asking how they can diversify in the event of a downturn in the local equities market. One solution being considered is to link up with managers from different sectors to provide another area of specialisation."

With such changes taking place in this asset class, van Eyk says managed funds are making a comeback but not in their original form.

"Fund managers are specialising in many more areas.

"Driving this as well are the baby boomers as they move towards retirement. They have been taught for the past five years that they cannot depend on bonds for income in retirement so they want different fund combinations that can provide them with what they need."

The increase in specialisation has led to more sectors in the managed funds arena. Whereas previously there used to be the traditional ones: fixed interest, international equities, Australian equities and property, van Eyk says he is now monitoring about 15.

Asset allocations

"There are many more funds to cater to these sectors but I think in the medium term talent will outperform and the funds that aren't performing will disappear," van Eyk says.

Choosing which managed fund to place your money into is a difficult decision. Last year, putting money into small cap funds would have almost assured a positive return, while this year Australian equities are performing well.

According to Graham Rich, director of investment publishing group Brilliant, there are good levels of funds

re's still some way to go

flowing into platforms, that is, master trusts and wrap accounts.

"The markets were shaky about two to three years ago but the stutters have now gone away," he says. "The performance of funds over the past three years, particularly in Australian equities, has outstripped the market indices." ???

Rich says fund managers were criticised for not adding value during the past three to five years, especially in light of the fees being charged, but they are now managing funds that are performing well, although he adds not all fund managers perform well all the time.

"Another change is that the incidence of investors buying into individual retail funds is low," he says. "There is more money being invested through platforms than through individual funds — in fact around 55 per cent of the money going into managed funds is coming through platforms."

Research house Assirt in its latest quarterly report, to March 2004, states that the overall platform value has increased because of good performance from asset classes. The BT-Westpac and Macquarie platforms continue to have the strongest net quarterly inflows. More than $674 million flowed into the BT-Westpac offering while $533 million flowed into Macquarie's. The National and AMP are the leading two providers of platforms based on funds under management.

Rich says one of the trends with managed funds is that alternative asset classes are receiving more attention.

"The traditional asset classes, especially international and Australian equities, are continuing to perform well while small caps, along with listed property trusts, are losing their attractiveness," he says.

"Index funds, while not attracting huge inflows, are attracting money as well but generally from institutional investors such as super funds rather than from individual retail investors."

However, Rich says with equity fund managers outperforming the index, even taking into account the fees charged, you would have to question why an investor would choose to put money in an index fund.

With so many funds available combined with the different styles of managers adopted — that is, value or growth — educating investors about the sector is becoming increasingly difficult.

Anthony Serhan, head of consulting at Morningstar, says trying to educate people about managed funds is a big issue.

"One of the trends that is ever present is the release of new products that invest in new and different asset classes," he says. "For example, a number of managers are now bringing out hedged international equity products — hedged in the traditional sense of being a currency hedge — and these need to be explained to investors."

Serhan says that in the managed funds sphere there is more choice for consumers but doesn't believe there is too much choice.

"Choice is a good thing for the market," he says. "There are simple solutions for the unsophisticated investor and more complex choices for the more experienced. However, I believe there may be too many products. On our database we have around 10,000 products of which 6500 are active. Most of the inflows into managed funds are going into 20 per cent of these products."

One of the issues, according to Serhan, is that if a large institution wants to bring out a product, it generally needs to bring out several versions to cover the different tax situations.

"For example, a fund manager may bring out a superannuation version, an allocated pension version and a straight investment option," he says. "All three have different tax structures although are investing in the same companies."

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Financial Planners & Other Intermediaries

Question 2.7

How important are intermediaries such as financial advisers in delivering outcomes for consumers?

Intermediaries and especially financial planners are extremely important in delivering outcomes for consumers. More than any other professional group, financial planners are interested in the financial literacy of consumers. They know that literate investors are easier to work with, are more likely to succeed and tend to remain clients longer than their less sophisticated counterparts.

In May this year my company conducted a survey of financial planners in all Australian States and Territories. As part of this survey Andex asked financial planners to indicate the extent to which they consider investor education an important function of their job as a financial planner.

The responses may be broken down as follows:

- 81.5% - "Extremely Important"
- 15.7% - "Important"
- 1.0% - Somewhat Important"
- 1.7% - "Unimportant"
- 0.0% - "Not at all Important"

Quite clearly the vast majority (97.2%) of financial planners deem investor education an "important" or "extremely important" function of their job. Is there any other professional group more concerned with financial literacy? As a group they must not be overlooked in the formulation of any national financial literacy strategy.

A Coordinating Body

Question 4.1

Is a coordinating body necessary? Should it be Government or industry funded? What functions should it perform?

I wholeheartedly endorse the idea of a coordinating body for the advancement of consumer and financial literacy in this country. As detailed above I believe the body should:

- advocate for a simplification of the legislative structure governing tax and superannuation
- work to benchmark consumer literacy
- catalogue the investor and consumer education initiatives in the market place
- identify gaps in the information available
- provide an accreditation service for information providers
- work with industry to standardise language used by financial services providers
- empower intermediaries in the market place to provide better education for their clients

I believe the body should be government funded, but see no reason it could not operate to totally self-fund.