

## Part 4

# The law governing disclosure of fees and charges in Australia

### **FEES AND CHARGES DEFINED**

#### **DEFINITION OF MAIN TERMS AND DESCRIPTION OF TYPICAL FEES**

Part 7.9 of the Corporations Regulations 2001 defines the following terms relating to fees and charges. As a general rule, these definitions apply only to superannuation products and retirement savings accounts (“RSAs”). Some of the definitions have been summarised:

- **Charge:** includes a charge made by a product issuer, service provider or other person and does not include a government charge, tax, or duty.
- **Contribution charge:** a charge which is not a death and disability insurance charge and is made either against contributions in respect of a product holder or against the holder or the holder’s benefits in a fund or financial product upon joining.
- **Death and disability insurance charge:** a charge against contributions, fund or product benefits, earnings or assets which the product issuer uses solely to pay insurance premiums (including stamp duty) or any charge by the product issuer for insurance against the product issuer’s liability to pay death or disability benefits.
- **Direct account charge:** a charge against product holder’s benefits which is not a contribution charge, death and disability insurance charge or exit charge.
- **Exit charge:** a charge against a product holder’s benefits which is only made when a payment is made in respect of a product holder or transferred.
- **Investment management charge:** a charge against a fund’s assets or investment earnings where fund expenses exceed direct account charges and which is not a transaction cost, direct account charge, contribution charge, death and disability insurance charge or exit charge.

- **Ongoing management charge (“OMC”)**: a charge against a product holder’s benefits in a fund or product, or against assets or earnings of the fund or product, and which is not a contribution charge, death and disability insurance charge, exit charge or switching charge, and which is made for a service that a product holder would not otherwise receive if the product holder had not requested and paid for the service, which is provided by the provider and is reasonable, and which is calculated in accordance with Schedule 10.<sup>13</sup>
- **Switching charge**: a charge against a product holder or the holder’s benefits in a fund or product made for the transfer of all or part of the holder’s benefits from one investment strategy to another.
- **Transaction cost**: brokerage, stamp duty or costs arising from maintenance of a property investment.

## AUSTRALIAN FINANCIAL PRODUCT DISCLOSURE

### FINANCIAL PRODUCTS

The Corporations Act 2001, as amended by the Financial Services Reform Act (“FSRA”) (“the Act”), defines a “financial product” in s 763A as:

[A] facility through which, or through the acquisition of which, a person does one or more of the following:

- (a) makes a financial investment (see section 763B);
- (b) manages financial risk (see section 763C);
- (c) makes non-cash payments (see section 763D).

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<sup>13</sup> Schedule 10 essentially provides as follows:

The formula is:  $\frac{MC}{AV}$  where:

**AV** = average value of fund assets during the income year, determined by mean average of net asset valuations made during that year.

**MC** = total amount of ongoing management charges for the year, excluding charges paid by a standard employer-sponsor of the fund.

If the underlying investments are managed by someone other than the product issuer (eg: external manager) and a charge is deducted from returns before the return is computed and credited, then that charge must be included in **MC**. A reasonable estimate of the charge must be made if the precise amount cannot be determined. Direct investment in shares or other securities listed in Australia is excluded.

Section 763B provides that a “financial investment” arises if:

- (a) the investor gives money or money’s worth (the *contribution*) to another person and any of the following apply:
  - (i) the other person uses the contribution to generate a financial return, or other benefit, for the investor;
  - (ii) the investor intends that the other person will use the contribution to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated);
  - (iii) the other person intends that the contribution will be used to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated); and
- (b) the investor has no day-to-day control over the use of the contribution to generate the return or benefit.

Section 763C provides that a person “manages financial risk” if they:

- (a) manage the financial consequences to them of particular circumstances happening;  
or
- (b) avoid or limit the financial consequences of fluctuations in, or in the value of, receipts or costs (including prices and interest rates).

The Act provides, in each of the above cases, examples of situations that are both within and outside the scope of the definitions; it is not necessary to reproduce those examples here. Additionally, the Act defines, at s 764D, when a person makes a “non-cash payment”; again, it is not necessary for the purposes of this report to examine that situation. Section 763E applies to those situations where a financial product is merely incidental to other facilities that are not within the s 763A definition of financial product.

Section 764A provides a list of things that are specifically prescribed as financial products. Of the broad range of financial products included in s 764A, those of most

interest are a security,<sup>14</sup> an interest in a registered scheme,<sup>15</sup> an interest in a managed investment scheme,<sup>16</sup> a superannuation interest<sup>17</sup> and a retirement savings account.<sup>18</sup>

Section 765A provides a list of things that are specifically prescribed as *not* financial products. This provision has effect despite anything previously stated to be specifically included within the definition of a financial product. Again, the list is quite extensive, but includes such things as health insurance,<sup>19</sup> reinsurance,<sup>20</sup> credit facilities,<sup>21</sup> facilities for settling non-cash payments<sup>22</sup> and currency exchange contracts.<sup>23</sup>

The analysis in this report is confined to the following products: superannuation and superannuation-like products (eg: annuities, RSAs, capital guaranteed funds, rollover funds and the like), and managed investment schemes (eg: managed funds, public offer unit trusts, cash management trusts, property trusts and the like).<sup>24</sup>

#### **FINANCIAL PRODUCT DISCLOSURE**

Part 7.9 deals with disclosure and some other matters relating to the issue and sale of financial products. Section 1010A provides that Part 7.9 does not generally apply in relation to securities; for provisions covering disclosure in relation to securities, the Act signposts Chapters 6CA and 6D, which cover prospectuses and related matters.

Section 1010B states initially that the Part does not apply to issues that are not made in the course of a business of issuing financial products. Section 1010B(2), however, states that the issue of any managed investment product or any superannuation product *is* taken to occur in the course of such a business.

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<sup>14</sup> Section 764A(1)(a).

<sup>15</sup> Section 764A(1)(b).

<sup>16</sup> Section 764A(1)(c).

<sup>17</sup> Section 764A(1)(g).

<sup>18</sup> Section 764A(1)(h).

<sup>19</sup> Section 765A(1)(c).

<sup>20</sup> Section 765A(1)(g).

<sup>21</sup> Section 765A(1)(h).

<sup>22</sup> Section 765A(1)(i) and (k).

<sup>23</sup> Section 765A(1)(m).

Sections 1012A, 1012B and 1012C establish the obligation to give a Product Disclosure Statement (“PDS”), respectively, when personal advice is given recommending a particular financial product, when an issue of or an offer to issue a financial product is made, or when an offer to sell a financial product is made.

### **CONTENT OF PRODUCT DISCLOSURE STATEMENTS**

The information in the PDS must be up to date as at the time at which the PDS is given (s 1012J). Section 1013A defines who is obliged to prepare the PDS: in the case of advice or the issuing (or offering thereof) of a financial product, the issuer is required to prepare the PDS; in the case of the sale (or offering thereof) of a financial product, the person making the sale or the offer to sell is required to prepare the PDS.

### **General Disclosure Requirements**

Section 1013B requires that the PDS be endorsed “Product Disclosure Statement” on its cover, or at or near the front of the PDS; in any other part of the PDS, the abbreviation “PDS” may be used.

Section 1013C is the general provision setting out the content requirements for PDSs. In sum, the PDS must contain:

- the statements and information required by s 1013D;
- the information required by s 1013E; and
- the information required by other provisions of this subdivision (namely, subdivision C).

Section 1013C(3) states that the information in the PDS “must be **worded and presented** in a clear, concise and effective manner” (emphasis added).

Presentation can be taken to include such matters as layout, format, typeface, graphics, colour, indexation, ordering, and lexicon. It can also be a reference to the use of appropriate and useful examples, tables and illustrations, or any other thing that

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<sup>24</sup> But not interests in unregistered management investment schemes which, generally, are small-scale offerings and comprise no more than 20 issues or sales in a 12-month period: r 7.9.16A, prescribing the same for the purposes of s 1012E(1)(b).

aids comprehension. Additionally, it can encompass the consideration of giving appropriate weight and prominence to those matters which require to be elevated in prominence due to their significance or nature. “Effective” also requires a consideration of the type of person who will read the PDS. It is to be noted that projections (ie, showing the effect of fees on returns) are not required by the Act or by the regulations made under the Act.

### **Specific Disclosure Requirements**

Section 1013D provides, relevantly, that a PDS must include “the following statements, and such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product”:

- (d) information about:
  - (i) the cost of the product; and
  - (ii) any amounts that will or may be payable by a holder of the product in respect of the product after its acquisition, and the times at which those amounts will or may be payable;<sup>25</sup> and
  - (iii) if the amounts paid in respect of the financial product and the amounts paid in respect of other financial products are paid into a common fund—any amounts that will or may be deducted from the fund by way of fees, expenses or charges;

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<sup>25</sup> Section 1013D(2) defines when an amount “will or may be payable”:

For the purposes of paragraph (1)(d), an amount will or may be payable in respect of a financial product by the holder of the financial product if:

- (a) the holder will or may have to pay an amount in respect of the product; or
- (b) an amount will or may be deducted from:
  - (i) a payment to be made by the holder; or
  - (ii) a payment to be made to the holder; or
  - (iii) an amount held on the holder’s behalf under the financial product; or
- (c) an account representing the holder’s interest in the financial product will or may be debited with an amount.

It includes an amount that the holder will or may have to pay, or that will or may be deducted or debited, as a fee, expense or charge in relation to a particular transaction in relation to the financial product.

Regulation 7.9.72A modifies the effect of s 1013D(1)(d) as if that section provides that information about amounts that will or may be payable state, instead, the basis on which the amount of liability would be calculated rather than specifying an amount.

- (e) if the product will or may generate a return to a holder of the product—information about any commission, or other similar payments, that will or may impact on the amount of such a return;
- (f) information about any other significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product;
- ...
- (k) any other statements or information required by the regulations.<sup>26</sup>

Section 1013E is a general provision requiring the PDS to contain “any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product”. The important point is that the provision requires such a decision to be made from the perspective of the retail client, not the issuer.

Section 1013F limits the extent to which information is required to be included. The provision is the flip-side of s 1013E and allows information to be left out of a PDS if it would not be reasonable to expect to find it in the PDS. Section 1013F(2) provides a non-exhaustive list of the matters that may be considered in determining whether it would not be reasonable to expect to find the information in the PDS:

- (a) the nature of the product (including its risk profile); and
- (b) the extent to which the product is well understood by the kinds of person who commonly acquire products of that kind as retail clients; and
- (c) the kinds of things such persons may reasonably be expected to know; and
- ...
- (e) the way in which the product is promoted, sold or distributed; and
- (f) any other matters specified in the regulations.

The reference in s 1013F(2)(b) to how “well understood” a product is might, on occasions, be taken to require product issuers to consider consumer testing surveys if

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<sup>26</sup> Section 1013D(4) gives some indication of the extent to which the regulations may (and do) dictate the requisite information of a PDS:

The regulations may:

- (a) provide that a provision of subsection (1) does not apply in a particular situation; or
- (b) provide that particular information is not required by a provision of subsection (1), either in a particular situation or generally; or

wanting to take advantage of this exemption from disclosure. Consideration of consumer understanding of product disclosure appears in Part 3 of this report.

### **THE REGULATIONS**

Many of the statutory provisions governing material to be included in a PDS make reference to the Corporations Regulations 2001 (as amended) (“**the Regulations**”).

Regulation 7.9.01 defines many of the terms used in the subsequent Regulations. As noted above, as a general rule these definitions apply only to superannuation products and RSA products. Without expanding unnecessarily, r 7.9.01 provides definitions of charge, contribution charge, death and disability insurance charge, direct account charge, exit charge, investment management charge, ongoing management charge, switching charge, and transaction cost.

Division 4 of the Regulations provides for the content of PDSs. The note to r 7.9.09 states that the Regulations set out the more-detailed information requirements pursuant to s 1013D(1). Regulation 7.9.09(1) limits the application of the Division to superannuation, RSA products and annuity products.<sup>27</sup>

Regulation 7.9.11 states that Schedule 10B sets out the additional information required by s 1013D(4)(c) in respect of superannuation and annuities that meet the standard set by r 1.05(4) of the Superannuation Industry (Supervision) Regulations 1994 (“**SIS**”). In respect of capital guaranteed funds, RSAs or annuities that do not meet the standard set by r 1.05(4) of SIS, the additional information is found in Schedule 10C.

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(c) provide a more detailed statement of the information that is required by a provision of subsection (1), either in a particular situation or generally.

<sup>27</sup> “Annuity” is defined by r 7.9.01 to have the same meaning as in r 1.05 of the Superannuation Industry (Supervision) Regulations 1994. The definition there is somewhat lengthy and technical but essentially an annuity is a contract under which the product holder is paid at least annually for the holder’s life, and thereafter to reversionary beneficiaries of the holder, subject to a number of requirements in respect of variations to the size, frequency and commutation of payments.

Part 5 of Schedule 10A of the Regulations provides that the Regulations may also make other arrangements for the format of a PDS, including the location of particular statements or information.

**Schedule 10B: Superannuation and Some Annuities**

Clause 1.8 requires the PDS to bear on its front or cover or first page:

A statement that a person who leaves the fund within a few years of joining may get back less than the amount of contributions paid because of the level of investment returns earned by the fund and the fund's charges.

Clause 6.1(c) requires the following:

[A] statement that the net earnings rate may not be the same as the rate credited to particular members because of the effect of charges made by the fund and, if relevant, the reserving policy of the fund;

Item 7, which covers fund charges, is extensive and is only reproduced below in part. Clause 7.1 states that, for any contribution charge, direct account charge, investment management charge, exit charge or switching charge, the PDS must give a description of the charge and:

- (b) the amount of the charge:
  - (i) expressed as a fixed amount; or
  - (ii) if it is not practicable to express [a] fixed amount, expressed as a percentage of:
    - (A) the contributions made in respect of a member; or
    - (B) the member's benefits in the fund; or
    - (C) the assets of the fund; and
- (c) against what, or to whom, the amount or percentage will be charged (for example, against contributions made in respect of the member to the fund or against the assets of the fund);...

Clause 7.2 requires the information in cl. 7.1 to be provided for any death and disability insurance charge of the fund.

Clause 7.3 requires a statement outlining the circumstances in which and the times when any charge may be increased or decreased, as well as any maximum limits on any charges.

For any of the charges in cl. 7.1, cl. 7.4 requires the product issuer to explain how a charge is to be determined if it cannot be expressed as an amount or a percentage.

In the case of a product offering different investment strategies, cl. 7.5 directs the product issuer to disclose the fee and charge information required by cl. 7.1 if those fees and charges differ as between each strategy.

If a death and disability charge is determined by a premium rate table, cl. 7.6 permits the PDS to attach that premium rate table and refer to it in respect of any such charge.

### **Ongoing Management Charges**

Disclosure of OMC varies depending on whether the financial product offers a single investment strategy or whether it offers a choice of investment strategies (eg: a superannuation fund that offers “conservative”, “balanced” and “growth” options for the investment of member funds, each option respectively having a higher risk/return profile than the preceding option).

Disclosure for financial products is best understood in terms of general and specific parts. All products, irrespective of investment strategy category, must disclose the general part. The specific part will vary depending on whether the product has a fixed investment strategy or offers a choice of strategies.

### General

Clause 8.1 requires the following statement to be disclosed for the “overall fund, the product issuer or the provider of an annuity”:

‘The ongoing management charges charged by a [*insert ‘trustee’, ‘life insurer’, ‘provider of an annuity’ or other appropriate description*] over a year can be expressed as a percentage of its assets.

In the last [*insert ‘year’, ‘2 years’, ‘3 years’, ‘4 years’ or ‘5 years’ as appropriate*], the ongoing management charges, expressed as a percentage of the fund’s assets, were:’

The statement is then completed according to whether the product offers only one investment strategy or a number of strategies.

### Single Investment Strategy Products

In this case, the provider provides:<sup>28</sup>

- (i) the actual ongoing management charge percentage for the required periods; and
- (ii) the actual ongoing management charge percentage relating to the management of investments for the required periods; and
- (iii) the actual ongoing management charge percentage not relating to the management of investments for the required periods.

The “required periods” are the latest year of income at the time the PDS is published and the 4 preceding years of income (but not a year of income ending on or before 30 June 2001).<sup>29</sup>

Following disclosure of this numerical information, the PDS must contain the following prescribed statement:

‘The approximate effect of the ongoing management charges (based on the charges for the year to [*insert most recent year*] on your benefits can be shown by multiplying this percentage by the amount in your account. The following example shows the approximate amount of the ongoing management charges for an account balance of \$10,000 in relation to the overall [*insert ‘fund’, ‘life insurer’, ‘provider of an annuity’ or other appropriate description*]. The actual effect of ongoing management charges will depend on the [*insert ‘fund’s’, ‘life insurer’s’ or other appropriate description*] charging arrangements and your individual circumstances. In particular, the amount in your account [*if more than one identified strategy – and your chosen investment strategy*] may have a significant effect on the amount of charges borne.’<sup>30</sup>

This statement is then “followed by an example deriving the converted amount for the overall fund, product issuer or provider of an annuity”.<sup>31</sup> The “converted amount” is

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<sup>28</sup> Corporations Regulations 2001, Schedule 10B, cl. 8.2(a).

<sup>29</sup> Corporations Regulations 2001, Schedule 10B, cl. 8.6.

<sup>30</sup> Corporations Regulations 2001, Schedule 10B, cl. 8.4(a).

<sup>31</sup> Ibid.

defined in cl. 8.3 as “\$10 000 multiplied by the ongoing management charge percentage”.<sup>32</sup>

A statement is then required which identifies the charges included in the OMC, in total and separated for investment and non-investment management expenditure, and which have been disclosed under cl. 8.1.<sup>33</sup> Then, the PDS must contain:

- (c) a statement that the person should read the charges section of the document; and
- (d) a statement that past charges should not be taken to be an indication of future charges; and
- (e) the statement:

‘The ongoing management charge for a [*insert ‘fund’, ‘life insurer’, ‘provider of an annuity’ or other appropriate description*] is required by law to be calculated and disclosed. Its purpose is to give a broad indication of the level of costs incurred by a particular fund or provider of an annuity as a percentage of the value of assets. Costs include all fees, charges and expenses except for [*insert ‘switching costs’,<sup>34</sup> ‘entry and exit charges’ or other appropriate description*]. The level of costs incurred by an individual product holder will depend on individual circumstances and as a percentage of value of the fund assets of the individual may be more or less than the ongoing management charge. The ongoing management charge should not be taken to be representative of the actual fees, charges and expenses that will be borne by an individual. Full details of fees, charges and expenses applicable to individual circumstances are set out in [*section X*] of this document.’

### Multiple Investment Strategy Products

Where the product has alternative identifiable investment strategies, the PDS must contain the same preliminary statement as required for a single strategy product but must also include the additional requirements in cl. 8.2. This requires, in much the same way as for a single strategy product, providing for each identified investment strategy: the same actual OMC percentage information for the required periods in respect of overall OMC, investment-management OMC and non-investment-

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<sup>32</sup> This definition is expressed to be applicable to cl. 8.2 (which is applicable to products having multiple investment strategies). Consistency would indicate that the “converted amount” ought be the same for single strategy and multiple strategy products. The fact that the foregoing prescribed statement refers to that same sum of \$10,000 seems to confirm that consistent approach.

<sup>33</sup> Corporations Regulations 2001, Schedule 10B, cl. 8.4(b).

management OMC, together with in each case, the “converted amount” for each percentage, or a statement:

- (i) of the highest and lowest actual ongoing management charge percentage for the required periods in respect of all investment strategies and the converted amount for each percentage; and
- (ii) of the highest and lowest actual ongoing management charge percentages relating to the management of investments for the required periods in respect of all investment strategies; and
- (iii) of the highest and lowest actual ongoing management charge percentages not relating to the management of investments for the required periods in respect of all investment strategies; and
- (iv) that information on the specific ongoing management charge calculations for a particular investment strategy are available on request, and details of how to request that information.

The prescribed statements and example required by cl. 8.4 are required as for single strategy products.<sup>35</sup>

Essentially, disclosure of OMC for superannuation and annuities varies depending on whether the product has one investment strategy or multiple strategies. The following table illustrates the distinction:

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<sup>34</sup> The second single-quotation mark appears to have been omitted.

<sup>35</sup> See nn 30-34, above, and text thereto.

**OMC Disclosure**  
**Schedule 10B – Corporations Regulations**

Single Strategy	Multiple Strategy
<p>cl. 8.1</p> <ul style="list-style-type: none"> <li>• Preamble statement</li> <li>• Overall OMC%, investment-mgmt OMC% and non-investment-mgmt OMC%</li> </ul> <p>cl. 8.4</p> <ul style="list-style-type: none"> <li>• Explanation of effect of OMC</li> <li>• Example based on \$10,000 for overall fund/product</li> <li>• Statement of charges included in each of overall OMC, investment-management OMC and non-investment-management OMC</li> <li>• Prescribed statements               <ul style="list-style-type: none"> <li>- Warning to read charges section</li> <li>- Notice that past charges do not necessarily indicate future charges</li> </ul> </li> <li>• Description of OMC and signpost</li> </ul>	<p>cl. 8.1</p> <ul style="list-style-type: none"> <li>• Preamble statement</li> </ul> <p>cl. 8.2</p> <ul style="list-style-type: none"> <li>• “For each identified investment strategy”: OMC% and converted amount, for each of overall OMC, investment-mgmt OMC and non-investment-mgmt OMC</li> </ul> <p>OR</p> <ul style="list-style-type: none"> <li>• “In respect of all investment strategies”: a statement of the highest and lowest OMC% and converted amount, for each of overall OMC, investment-mgmt OMC and non-investment-mgmt OMC, and a notice that OMC calculations specific to particular strategies is available on request</li> </ul> <p>cl. 8.4</p> <ul style="list-style-type: none"> <li>• Explanation of effect of OMC</li> <li>• Example based on \$10,000 for overall fund/product</li> <li>• Statement of charges included in each of overall OMC, investment-mgmt OMC and non-investment-mgmt OMC</li> <li>• Prescribed statements               <ul style="list-style-type: none"> <li>- Warning to read charges section</li> <li>- Notice that past charges do not necessarily indicate future charges</li> </ul> </li> <li>• Description of OMC and signpost</li> </ul>

Where a prospective investor requests further information in the case of a product having multiple investment strategies, r 7.9.12 states that where a product issuer has provided a PDS that complies with cl. 8.2(b), a request for further information must be met by provision of the information that would have to be disclosed under cl. 8.1 in respect of single strategy products. That disclosure would then provide an accurate indication of OMC percentages, rather than merely the highest and lowest OMC percentages.<sup>36</sup> Although the heading to r 7.9.12 implies that the regulation is confined to standard employer-sponsors and successor superannuation funds, the content of the regulation itself suggests no such limitation.

The numerical OMC information must not be more than 15 months out of date.<sup>37</sup>

### **Schedule 10C: Capital Guaranteed Funds, RSAs and Some Annuities**<sup>38</sup>

Item 7 of Schedule 10C is similar to the corresponding item in Schedule 10B; there are two main differences:

- Clause 7.1 – charges: the applicable charges are slightly different, given the nature of the products covered by this schedule. They are: “any contribution charge, direct account charge or exit charge of a capital guaranteed fund”.
- Clause 7.4: this is unique to Schedule 10C:

If fees and charges are deducted before interest is credited to the fund — a statement to the effect that interest is paid net of expenses.

There is no requirement in Schedule 10C to disclose prescribed statements along the lines of item 8 of Schedule 10B.

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<sup>36</sup> Corporations Regulations 2001, r 7.9.12 modifying s 1017A of the Act for the purposes of s 1020G(1)(c) of the Act.

<sup>37</sup> Corporations Regulations 2001, Schedule 10B, cl. 8.7.

<sup>38</sup> The signpost to the heading to Schedule 10C erroneously refers to r 7.912; it should refer to r 7.9.11.