FEES AND ONGOING SERVICE

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BACKGROUND

All financial decisions in life require an assessment of the costs and benefits involved. This is true when purchasing fruit, buying a car or choosing a financial investment such as a superannuation or pension fund. It is however important to ensure that you are comparing “apples with apples”.

Take the example of purchasing a car. If two dealerships offer exactly the same car, with the same options and same warranty for different prices, the comparison is straight forward and the consumer should purchase the cheaper of the two. However, if the price from one dealer includes scheduled servicing of the car and the other does not, then the cost differential can no longer be seen as being the only relevant factor.

One would expect that the dealer that includes scheduled servicing with the car would be charging a higher price than the dealer that is not. We are now comparing “apples with oranges”, in that we are comparing the price of (a) a car alone; against (b) the same car with scheduled servicing. The consumer must decide whether the additional cost, covering the scheduled services, justifies the higher charge.

The same is equally true with financial products. Over recent years the “compare the pair” campaign has purely targeted fee differentials on superannuation funds. It maintains that the end outcome in retirement savings is purely based on a fee differential. This is not necessarily the case, as can be seen on page 2.

Although there are many different arrangements in practice, for simplification we will break the comparisons down to the major two arrangements.

THE TWO MAJOR ARRANGEMENTS

1. Type one – “product only”

By “product only”, we mean that you are purchasing a fund and no ongoing advice. When you purchase a fund, your investment will stay in the same investment strategy inside that fund, until you direct the fund to do something different.

Most fund providers will offer a range of investment options, all at different costs. In order to make a comparison of “apples to apples” possible, we will look at comparisons of a fund’s default “balanced” option.

— REST 0.73% for Super, 0.74% for Pension
— AustralianSuper 0.67% for Super, 0.73% for Pension
— HOSTPLUS 10% for Super , 1.07% for Pension

Even this comparison is not strictly “apples with apples” as the fees shown above relate to the investment of the funds and percentage-based management fees but there are other associated costs for management, transactions etc. (for example, all three charge an additional flat fee ranging from $1.50 to $2.25 per week for administration expenses). However, these additional costs will be ignored for the sake of simplicity.

Therefore, on a “product only” basis, one can make a comparison between these products. There will always be other factors (one fund may have better administration or website access than the other), but generally they are offering a generic product.

2. Type two – “product and service”

This is a bit like the car dealer which includes scheduled servicing with the cost of the car. Under a “product and service” arrangement, you are getting the investment of the funds, but you are also receiving ongoing access to support services.

None of the industry funds shown above offer a “product and service” offering. In these funds you invest and the portfolio stays the same until you, the investor, tell the fund to do something different. In a “product and service” environment, there is an ongoing relationship between you, the fund and an adviser. There seem to be no funds out there that offer this option any longer.

If deciding to invest with a Balanced fund, the “balanced fund investor” now has a choice. Clearly the “product only” route will be cheapest, but they are then on their own in terms of future direction of their investments. Their alternative is to pay a higher annual fee in a “product and service” arrangement, knowing that this includes access to ongoing financial planning to assist with the managing of the portfolio.

The $64,000 question is whether the value added for ongoing access to the financial adviser justifies the higher charge.

This will depend on the level of access provided and what value the adviser actually adds.

SERVICES OFFERED BY BL&A

BL&A are able to provide clients with access to both types of service. This means that we are able to assist clients who are after “product only” as well as those who wish to have “product and service”.

1. Type one – “product only”

Where a client is looking for “product only”, we will not be recommending that they use industry funds. There are several reasons for this.

1. Fees. As will be seen later, it is not necessarily true that industry funds are the cheapest option. Wholesale funds (requiring a minimum $1500 investment) can offer comparable and even cheaper fees than industry funds.

2. Administration. We firmly believe that the administration within industry funds is the worst in Australia, with lengthy and onerous administration practices. For example, the REST website states that any request to switch investment options will become effective two business days after REST receives the request. This makes movement of portfolios very difficult, as markets can change drastically over such a delay.

3. Investment choice. Generally speaking, industry funds will offer a maximum of around a dozen investment choices. This compares to more than a hundred choices in a wholesale platform. We believe that the limited range of investment options within these funds is restrictive to the long term benefit of the clients.

4. Access to Data. Ability for BL&A to see client transactions for future dealings.

This last point is probably the most important. If we are to place a client in a “product only” arrangement in a wholesale fund, the fund manager recognises that we are the adviser of that client. Consequently, we will receive nightly balances and transaction records from the fund manager, through our XPLAN system. Should a client wish to utilise our services again, we will then have complete access to view the client’s history in that fund; knowing their balance, investment mix, contribution history, tax status etc. Most industry funds do not provide this access, so when a client of ours uses an industry fund, we have no idea of what transactions are taking place. If the client wants subsequent advice down the track, we have to “start from scratch” with regard to their investments.

If a client invests through BL&A, even on a “product only basis”, all dealings from the client with BL&A concerning their investment will be charged to the client at our hourly rate. This will apply to emails, phone calls, meetings or general correspondence, regardless of the time involved. It is also possible that a client, at some stage in the future, will wish to move from a “product only” arrangement to a “product and service” arrangement. If the client had started out using an industry fund, we would, at that point, have to move everything out of the industry fund into the wholesale fund. However, if they are already in the wholesale fund, all we need to do is to adjust the fee structure of the fund.

2. Type two – “product and service”

When offering “product and service” arrangements, we also use wholesale funds. This minimises fees, while maximising good administration, investment choice and provides us with the all-important access to client information through our XPLAN system.

The ongoing service that we provide is explained in the document ***Investing through BL&A***. As explained in this document, it involves the ongoing review of your arrangements, making ongoing recommendations and changes to the investment strategies you are using. We suggest that you read this document for additional detail.

COMPARING APPLES WITH APPLES

1. Type one – “product only”

As shown above, the cost of maintaining a “balanced” investment strategy in these industry funds is between 0.67% and 1.10%. If a client wishes to enter into a “product only” arrangement with a fund which we recommend, our first choice is likely to be the Colonial First State Wholesale platform. In this platform, there are two balanced options from which to choose:

CFS W/s Index Diversified Fund	– 0.51%
CFS W/s Index Growth Fund	– 0.56%

The fees charged by these options are clearly below those offered by the industry funds shown previously. Therefore, it is not true to say that industry funds will always be the least expensive option.

It is also important to note, that holding our own AFSL licence, we are not “tied” to any one fund manager. The Colonial First State Wholesale platform referred to above is one of a dozen or so funds on our recommended list. We are free to recommend and use any of these funds, not just Colonial.

2. Type two - Product and service

As explained in our separate brochure (***Investing through BL&A***), we provide ongoing service to clients who request it. This includes the review and rebalancing of their portfolio as well as the provision of the ongoing advice.

Our cost for the “service” component is 0.66% (GST inclusive). This means that if a client wanted “product and service”, using the Colonial First State Wholesale Index Diversified Fund, their total cost would be 0.51% + 0.66% = 1.17% per annum.

It would be unusual for a client to only have one investment option in place. As can be seen in the brochure ***Using the BL&A “Bucket approach” to investing***, the reality is that most clients will have a combination of short, medium and long term investment strategies within their funds. Each investment option is going to have a different management cost.

In a typical client portfolio, an investor is likely to have some funds in cash, some in a balanced fund and some in shares. If we allocate hypothetical percentages to each of these investment options, we can compare the respective costs of different “product and service” offerings.

Product and Service offering using the Colonial First State Wholesale Fund

With these percentages applying to these investment options, the cost of running a “product and service” option would be 0.39% (Management Fee) + 0.66% (Adviser Service Fee)= 1.05%.

Bucket	Fund	Percent	Management Fee
One	FirstRate Wholesale Saver	20%	0.35%
Two	Colonial First State Wholesale Index Diversified	30%	0.51%
Three	Colonial First State Wholesale Index Australian Shares	25%	0.34%
Three	Colonial First State Wholesale Index Global Shares	25%	0.35%

COMPARING APPLES WITH ORANGES

As shown on the previous page, if price is the critical issue for the client, BL&A are able to offer services that are extremely price competitive. This is regardless of whether the client wishes to invest on a “product only” basis, or use a “product and service” arrangement. It is therefore true to say that when comparing “apples with apples” these arrangements are competitive.

It is also important to stress that price does not have to be the sole determining factor going forward. The reason why someone would pay a higher fee for “product and service” compared to simply using “product only” is because they believe that the extra cost will be rewarded with greater returns over time.

If a client looks to use a “product and service” arrangement with BL&A, there is no obligation to stick to a “balanced portfolio”, merely because it is a cheap option.

We believe that the investment mix for each client should reflect a number of factors, including their consumption timeframe (refer separate document –***Using the BL&A “Bucket approach” to investing).***

Under our “bucket model”, a client will not necessarily have a “balanced portfolio”. Depending on their consumption timeframe, they may have different weightings of growth and defensive assets within their portfolio. This changes the cost of the fund (generally speaking, the more defensive the portfolio the cheaper it is).

An additional option that investors may wish to consider is the possibility of using “internal gearing” within the growth part of the portfolio. This is explained in the separate document ***Inside the 3rd bucket – a generic look at the impact of gearing***.

Although one should read this separate document, internal gearing is where the fund borrows extra capital, to increase its exposure to the share market. This approach accentuates gains in market rises and losses in market falls. Funds which utilise internal gearing are more expensive than those which do not but they are providing the investor with a greater exposure to the share market. This is something that some clients will be interested in, while others will not. The ability to move between geared and non-geared positions is easily done when investing in wholesale funds, where industry funds do not provide these options. This enables the portfolio to be individually designed around the needs of the investor.

These latter options are very much a case of comparing “apples to oranges”. There is no doubt that adding internal gearing to a portfolio will make it more expensive. However, if this improves the overall performance of the portfolio, it may be a cost worth paying.

Coming back to our car analogy, when an individual purchases a car, they start at a “base level” and then work out what options (leather seats, reversing camera, etc.) that they wish to include. Every “option” adds to the cost, however the consumer will add that option if they believe that this extra cost is justified.

The same applies to the options discussed here. The “product only” placement in the balanced fund is the cheapest available option. All extensions on this (including ongoing service, the use of buckets or internal gearing) are like the leather seats in the car and will add to the cost.

Just like the leather seats, every individual has the ability to dictate whether they want the base model or are willing to pay for the extras.

Regardless of this choice, we believe that BL&A offers competitive arrangements, particularly in the provision of ongoing service.

Companion documents:

Investing through BL&A
Using the BL&A "Bucket approach" to investing
Inside the 3rd bucket – a generic look at the impact of gearing