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USE AND USEFULNESS OF PDSs in the financial planning context

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Following considerable criticism of the complexity and lack of readability of product disclosure statements (PDSs), regulatory changes were introduced requiring shorter PDSs for certain investment products. This paper reports the findings of an online survey of financial planners regarding use of managed investment scheme (MIS) PDSs with clients, the perceived usefulness of PDSs as an information source, and their views on shorter PDSs. Our findings highlight major concerns about the usefulness of the PDS and disclosure reforms.¹

Significant reforms to the financial services sector since the early 2000s have ‘enshrined disclosure as a key consumer financial protection measure in Australia’ (Sandlant 2011, p. 44). Adequate disclosure of investment product information is essential for consumers to make informed investment decisions. Disclosure regulations emerging from the Financial Services Reform Act 2001 established product disclosure statements (PDSs) as a measure aimed at informing and protecting investors in managed investment schemes. However, over time, PDSs came under fire² for becoming too long, complex and unreadable for most people,³ turning into more of a tool for product providers to manage their liabilities than inform consumers (Sandlant 2011). To address these concerns, the government embarked on a further set of reforms to shorten, simplify and improve the readability of PDSs.

In 2010 the government announced the commencement of new regulations prescribing shorter PDSs for margin loans, superannuation and ‘simple’ managed investment schemes (Bowen 2010). However, in December 2011, in response to industry concerns, the government announced the exclusion of superannuation, multi-funds and hedge funds from the shorter PDS regime, pending further consultation with industry and consumer groups (Shorten 2011). Thus shorter PDS regulation presently applies to only a limited range of simple investment products.

Little is known about the interaction between disclosure via PDSs and advice by financial planners regarding managed investment schemes (MIS). The extent to which shorter PDSs (required for all simple MIS since June 2012) are likely to address the limitations of longer PDSs is also not clear. We address these issues through an online survey of financial advisers seeking information about their perceptions and use of PDSs in the advice context.

Survey of financial advisers
Fifty-one financial planners and advisers were recruited through email and website promotion of the survey to members of Finsia in mid-2012. This diverse sample comprised 41 authorised representatives and 10 employee representatives, with 40 males and 11 females. Most were aged between 35 and 64, with 28 per cent aged 35–44 years, 33 per cent aged 45–54 years, and 25 per cent aged 55–64 years. Advisors have been in their current role an average of 11 years. Education qualifications ranged from TAFE to (in one case) a PhD. Thirty-five per cent are remunerated through salary alone, 22 per cent through fee for service alone, 14 per cent through other sources such as profit shares, bonuses and consulting, 29 per cent through various combinations of salary, commission, fee for service and profit shares/bonuses/consulting, and one adviser through commission alone.

To ensure familiarity with MIS PDS usage, advisers participating in the survey were required to have clients with investments in at least one type of MIS. Between 85 per cent and 90 per cent reported having clients invested in share or equity trusts, multi-funds, property based trusts, and/or cash management trusts; 75 per cent had clients in wrap or Investor Directed Portfolio Services (IDPS); 49 per cent in mortgage funds, 23 per cent in other funds such as strata and film, and 22 per cent in agricultural funds.
When asked what type and sources of information advisers typically provide to clients considering MIS products purchase, not surprisingly, all reported providing (legally required) PDSs. Figure 2 shows that after PDSs, the next most common sources of information provided are verbal information, third-party research material, product material and adviser research.

The frequencies of responses shown in Figures 1 and 2 indicate that while advisers seek a wide range of information sources to advise their clients, they do not necessarily directly share all of that information with clients. For example, all advisers conduct research to advise clients on a MIS product investment, but less than two-thirds provide that research to their clients.

Figure 3 shows that, as expected, the vast majority of advisers thought there was high usage of the verbal information that they provided to clients with 80 per cent indicating it was used by many or all clients.

**Information sources used by advisers and clients**

We asked advisers to assess the use and usefulness of a range of information sources they might typically use in deciding to recommend a particular MIS to clients. Figure 1 shows that advisers’ own research is used by all respondents, with 81 per cent rating it as the most useful in terms of ‘moderately useful’ or ‘very useful’. Research provided by third parties was rated the next most useful (75 per cent). Notably, while almost all advisers indicated they use information in PDSs, only about half rated that information as moderately or very useful. This relatively low usefulness rating was not much higher than for the next three major information sources (product brochures, investment product websites and another financial expert) at around 40 per cent. The sources considered the least useful or not used, were financial newsletters, verbal information from other advisers, financial press articles, information from accountants, internet blogs or chat rooms and advertisements.

**FIGURE 1: Sources of information used by advisers in recommending MISs to clients**

*Source Data: Finsia Journal of Applied Finance, Issue 1 2013*

**FIGURE 2: Sources of information provided by advisers**

*Source Data: Finsia Journal of Applied Finance, Issue 1 2013*
of their clients. Product research conducted by advisers or licensees was considered the next most highly used information by many or all clients (65 per cent), followed by the Financial Services Guide or Statement of Advice (51 per cent). Surprisingly, only a little over a quarter of advisers thought the PDS was used by most or all of their clients, with the remainder indicating PDSs were either not used or used by only a few clients.

The results suggest that advisers view the information they personally provide to be the principal sources of information used by clients in their MIS investment decisions, and relatively few advisers consider third-party sources, including the PDS, as client information sources.

**Purpose of PDSs and client friendliness**

The majority of advisers agreed that the purposes of the PDS are to provide all key information for making sound investment decisions (71 per cent), and to ensure companies cover their legal and regulatory obligations (75 per cent). However, the credibility of the information was questioned with only a minority agreeing that PDSs provide unbiased (29 per cent) or trustworthy (35 per cent) information.

When asked to rate the client friendliness of PDSs associated with each type of MIS, advisers considered cash management trusts to be the most readable and easy to understand with all other types widely thought to be either ‘not client friendly’ or only ‘a little client friendly’ (Figure 4).

It also appears that advisers perceive that a relatively large proportion of their clients prefer paper-based PDSs rather than accessing them electronically (although around one-third indicated that clients would be happy to access PDSs via email or website). Further analysis shows that two-thirds of advisers who indicated their clients would prefer to receive a paper document also felt that their clients would not be happy to access PDSs online. This finding has important implications for trends towards making

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**FIGURE 3: Adviser perceptions of client use of information sources**

![Image of Figure 3](image-url)

**FIGURE 4: Percentage of advisers indicating client friendliness of PDSs**

![Image of Figure 4](image-url)
more online PDS information, particularly in relation to incorporating information by reference (IBR), which is discussed further in the context of shorter PDSs.

**Use of PDSs in the advice context**

When asked to indicate how they use PDSs with clients, the majority (59 per cent) of advisers provide the PDS and recommend clients read it in full. Few identify the sections most relevant for their clients to read (16 per cent), discuss relevant sections with their clients (12 per cent), or go over the PDS in detail (10 per cent); suggesting advisers do not incorporate PDSs as a central source of information in MIS product advice.

The majority of advisers thought that a range of characteristics of PDSs were large barriers to clients’ reading and understanding (see Figure 5). These barriers include time to read (71 per cent), length of document (71 per cent), complexity (69 per cent), amount of information (69 per cent), use of financial and legal terminology (59 per cent), and level of financial knowledge required (57 per cent). The generally high frequencies of advisers rating all the factors as moderate or large barriers is consistent with the general view that PDSs are too long, complex, and difficult to read and understand.

**Disclosure reforms and shorter PDSs**

Policy makers have acknowledged that one of the ‘drivers’ of overly long PDSs has been the principles-based disclosure regime, with product providers responding to the absence of specific details of legally required information by erring on the side of caution and including all information considered relevant for users’ investment decision making (Treasury 2009a). The government’s commitment to shorten and simplify PDSs necessarily adopts a prescriptive approach to content standardisation and making them more readable for users, while also reducing compliance costs for issuers (Treasury 2010). Whether shorter PDSs will achieve the objective of being more effective in informing investment decision making (Treasury 2010) is yet to be established.

In the survey of advisers we sought their views on the policy reforms prescribing PDS length, structure and content by asking them about key proposed changes. As expected, a majority (90 per cent) agreed that changes to PDSs to make them more readable and client friendly were a good idea. However, there was less agreement on document length, with 57 per cent agreeing that limiting PDSs to eight pages is a good idea. Interestingly, despite the majority supporting PDS length reduction, more than half (53 per cent) agreed the PDSs should include all information for sound decision making, regardless of length.

Incorporation by reference (IBR) plays a key role in limiting PDS length by allowing information that is legally part of the document to be located elsewhere, with reference in the document to where that additional information can be found (Treasury 2010). Just over half of the surveyed advisers agreed that IBR is a good idea, but only a small percentage thought that their clients were likely to access additional information. Our findings suggest there is a tension between recognising the need to make PDSs shorter and more client friendly and the reality that clients are unlikely to access important investment information located outside the PDS. This finding casts some doubt on whether more informed investment decision making is achievable with shorter PDSs.

**Usefulness of investment information in shorter PDSs**

Table 1 shows the information presented in Section 5 of Treasury’s (2009b) model shorter PDS, ‘XYZ Managed Investment Fund’, as developed for a ‘simple’ MIS.

While 55 per cent of advisers agreed that this information would be helpful in making an investment decision, less than half (45 per cent) agreed asset-class information was easy to understand. Furthermore, advisers were divided on whether the risk and return information was easy to understand, with 37 per cent agreeing and 37 per cent disagreeing (26 per cent neutral). The majority (73 per cent) of advisers agreed on the need for more...
Our findings suggest that while advisers follow their legislative obligation in providing clients with PDSs, they are sceptical about their decision-making usefulness in the managed investment context, both for themselves and their clients. Consistent with previous consumer research findings (see Treasury 2010), advisers believe that clients find PDSs cumbersome and complex, and generally unfriendly. While advisers perceive themselves as making more use of PDSs than their clients, they tend to assess them as biased and untrustworthy, and lacking detailed information about the nature of the managed investments. Accordingly, advisers are more likely to assess PDS content in a broader context of investment market conditions, assumptions, investment strategies and fund managers’ track records. Given this perception, it is not surprising that few advisers spend time going over the PDS with their clients, believing that only a few of their clients utilise PDSs in making investment decisions, instead relying on other information provided by the advisers.

Our findings suggest that clients and advisers have different PDS information needs, and decisions about investments in managed investment schemes are often based on multiple sources of information on the impact of various investment-performance risks, which suggests that any related IBR information would need to be accessed before making an investment decision.

About two-thirds agreed that further information regarding risk and return is needed, with four predominant information themes emerging: (1) definitions of risk and return and alternative methods of how they are presented; (2) details about asset classes underlying investment options and investment strategies; (3) fund managers’ expertise and performance; and (4) effects of changes in economic conditions on expected outcomes.

In relation to the first theme, just under half (45 per cent) of the advisers who indicated more information is needed, thought that there was insufficient detail with regard to risk types, definitions and presentation. Others identified the difference between clients and the financial industry in terms of risk perception and definition. Some considered the presentation of risk and return information needed to be supplemented or presented in an alternative form.

The various adviser comments highlight the need for diverse and complex information for informed investment decision making and that shorter PDSs and supplementary disclosures incorporated by reference are unlikely to satisfy that need. Interestingly, one adviser commented that no further information was required in the PDS table as ‘that is the role of the adviser’, suggesting detailed disclosures to clients about investments are unnecessary.

**Conclusion**

Our findings suggest that while advisers follow their legislative obligation in providing clients with PDSs, they are sceptical about their decision-making usefulness in the managed investment context, both for themselves and their clients. Consistent with previous consumer research findings (see Treasury 2010), advisers believe that clients find PDSs cumbersome and complex, and generally unfriendly. While advisers perceive themselves as making more use of PDSs than their clients, they tend to assess them as biased and untrustworthy, and lacking detailed information about the nature of the managed investments. Accordingly, advisers are more likely to assess PDS content in a broader context of investment market conditions, assumptions, investment strategies and fund managers’ track records. Given this perception, it is not surprising that few advisers spend time going over the PDS with their clients, believing that only a few of their clients utilise PDSs in making investment decisions, instead relying on other information provided by the advisers.

Our findings suggest that clients and advisers have different PDS information needs, and decisions about investments in managed investment schemes are often based on multiple sources of information.
rather than one. Relative to clients, advisers tend to be more sophisticated investors and seek detailed information from multiple sources, one of which is the PDS. Differing information needs partly reflect certain client characteristics which potentially militate against the effective use of disclosure information including behavioural biases and financial literacy levels.

With respect to reforms to shorten PDSs, there is some sense that simplified PDSs might be more client friendly but of less use in effective decision making, with most advisers agreeing with reducing length but not information content. While removing information and incorporating it by reference to an external source is also considered a good idea, few believe that their clients will access the additional information. These findings are consistent with US research on simplified mutual fund disclosure which found no evidence that shortened prospectuses (Summary Prospectuses) improve investor decision making (Beshears et al. 2011).

Our findings also add to ongoing debates about the manipulation of disclosures and the overreliance on PDSs as a regulatory strategy (Donald 2009). As Kingsford Smith (2011, p. 339) notes, although disclosure remains a central regulatory strategy, ‘it is unlikely that tinkering with the form and presentation of financial disclosure will make a dramatic difference’. Given the growing financial advice market, perhaps policies aimed at designing ‘disclosure to be more helpful to advisers in comparing products and making their recommendations’ (Sandlant, 2011, p. 44) might be a more fruitful pursuit, rather than focusing solely on the laudable, but difficult to attain, goal of providing investors with information that is both user friendly and sufficiently comprehensive to facilitate informed decision making. The current one-size-fits-all approach may in fact fit very few. Clearly, further research is needed to inform future policy directions on product disclosures.

Notes
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2. See, for example, submissions to the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS 2007) inquiry into the structure and operation of the superannuation industry.

References