

Chapter Eight

Fees and Charges

Introduction

8.1 Superannuation and life insurance products vary greatly in terms of what they offer to members. The nature and size of a fund can also influence the level of fees and charges which apply, with larger funds possibly being able to take advantage of economies of scale with regard to fixed costs. This chapter examines the:

- impact of fees and charges on fund balances and retirement incomes;
- suggestions to address entry and exit fees; and
- proposals to monitor fees and charges.

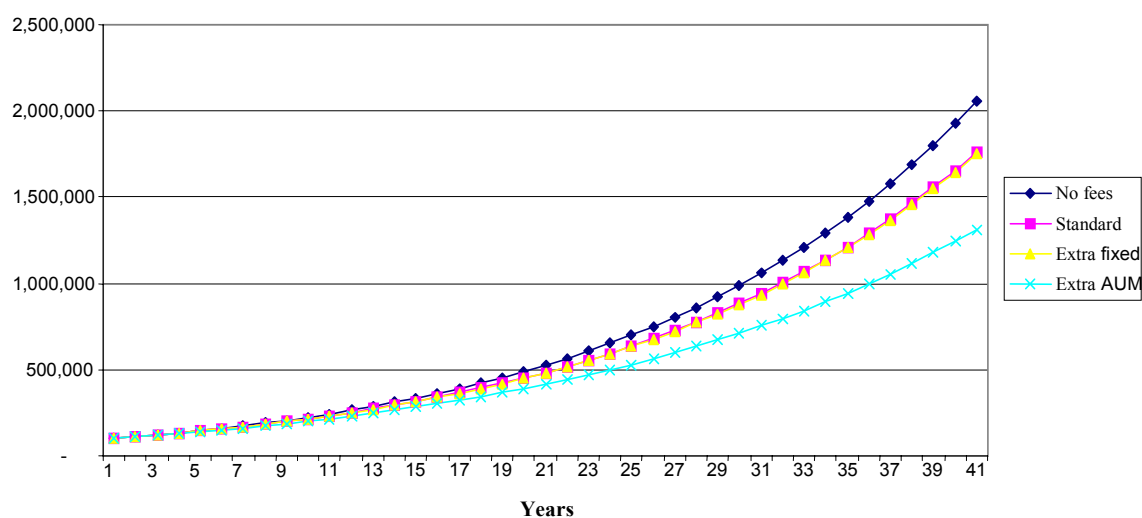
The impact of fees and charges

8.2 During the inquiry, several witnesses noted that even small differences in fund fees and charges can have a substantial impact in terms of fund returns and retirement incomes over a 40 year period. Mr Gallagher from the Treasury acknowledged this point in evidence to the Committee on 11 September 2002.¹ In fact, Treasury's assumptions about the adequacy of retirement incomes use an assumed fee of 1 or 1.2 per cent, which the Committee notes is significantly lower than many retail funds offer.²

8.3 The Committee cites below a graph provided by Sunsuper on the effect of fees on the balance of a fund over 40 years, based on an initial balance of \$100,000:

1 *Committee Hansard*, 11 September 2002, p. 305.

2 See Department of the Treasury, evidence to the Committee's inquiry into superannuation and standards of living in retirement - Submission No 142.

Chart 1: Effect of Fees – Accumulation over 40 Years

Source: Submission 39, Sunsuper, p. 3.

Assumptions:

Interest of 6 per cent after tax before fees

Inflation of 3 per cent per annum

15 per cent tax on contributions

Initial annual contribution of \$5,000

Standard fees - \$1 per week and 0.5 per cent per annum asset fee

Extra fixed is extra \$1 per week. Extra fee for assets under management (AUM) is 1 per cent per annum.

8.4 The graph shows that over a 40 year period, based on an initial balance of \$100,000 and the assumptions listed above, an extra management fee of one per cent per annum would reduce the fund balance in its 40th year from \$1,759,000 to \$1,314,000, a difference of \$445,000.

8.5 Given the impact that higher costs and lower returns have on fund balances over a 40 year period, the ACTU argued that the introduction of choice of fund via the current Bill would lead to lower retirement incomes in Australia:

Increasing retail selling opportunities for large financial institutions in the management of legally mandated superannuation contributions will not be in the interests of maximising the retirement incomes of fund members. International and local experience shows that the result of this process is likely to be to force up costs and weaken performance, to the long-term detriment of fund members and the whole Australian community.³

8.6 Similarly, Quadrant Superannuation expressed concerns that even where individual employees stay in not-for-profit funds that are currently performing well,

3 Submission 5, ACTU, p. 4.

they may ultimately face higher costs and lower returns should the current Bill be implemented.⁴

8.7 In this regard, Senator Sherry expressed concern in the hearing on 11 September 2002 that if fund returns decline and costs rise under choice, the community will ultimately have to provide additional support to retirees through the social security system.⁵

Entry and exit fees

8.8 Various suggestions were made during the inquiry to address the issues of fund entry and exit fees, with some parties advocating a cap on entry or exit fees, while others proposed a prohibition on all such fees.

8.9 For example, during hearings, Senator Sherry raised the Labor Party's proposal for an overall cap on ongoing fees and charges – such as investment management and fund administrative fees – set at 1.2 per cent of a fund's balance, which is currently the industry norm, together with the prohibition of entry and exit fees above a small processing charge.⁶

8.10 In response, IFSA opposed a cap on fees in its written submission, on the basis that a competitive and transparent market is the most appropriate means of placing downward pressure on fees. It cited an IFSA commissioned report entitled *Superannuation Fees and Competition* showing a high level of price and product competition within the market. By contrast, IFSA suggested that placing caps on fees and charges could lead to:

- creeping up of prices to the ceiling price;
- withdrawal of advice and education on retirement incomes from the workplace;
- barriers to entry for new players in the market; and
- exit from the market of product providers.⁷

8.11 These arguments were repeated in hearings. For example, in his evidence to the Committee, Mr Rosario from Westscheme noted that capping fees may have the inverse impact of stopping people from being able to get information on investment choices, or being free to choose their managers – thereby in effect not maximising their superannuation benefit.⁸ Similarly, Mr Ward from Mercers stated in evidence on 2 September 2002:

4 *Submission 14*, Quadrant Superannuation, p. 2.

5 *Committee Hansard*, 11 September 2002, p. 305.

6 See for example *Committee Hansard*, 11 September 2002, p. 242.

7 *Submission 36*, IFSA, pp. 4-5.

8 *Committee Hansard*, 2 September 2002, p. 65.

I would be concerned about a cap on fees and charges overall because I think if you put a cap on it it stops initiative and it stops a fund developing new and additional services. They cannot afford to because they are limited by the cap.⁹

8.12 Similarly, Mr Gilbert from IFSA also argued against a cap on fees and charges at 1.2 per cent of a fund's balance, on the basis that it could lead to a creeping up of prices to hit the 1.2 per cent ceiling. In addition, those funds that were already above the 1.2 per cent ceiling could cease to operate, thereby reducing investment options in the market place and inhibiting choice.¹⁰ Mr Thomas from the Treasury expressed the same view.¹¹

8.13 In response, Mr Silk from the Industry Funds Forum argued that a cap on fees would not necessarily lead to a migration to the cap. He suggested that in an efficient market, a higher cap on fees should have no impact on those parties that are currently charging less than the proposed cap.¹²

8.14 In their submissions to the inquiry, parties such as Cbus and AIST argued for a prohibition on entry and exit fees associated with the Choice Bill, other than charging the employee an amount to cover the administration of entry and exit.¹³ Cbus cited in particular the example of a member of MLC Master Key Gold Star, who would have incurred a withdrawal fee of \$3,297.69, or 100.7 per cent of the account's balance, if they had rolled out of the fund.¹⁴ In addition, Cbus cited the following table of exit penalties of which it is aware:

9 *Committee Hansard*, 2 September 2002, p. 103.

10 *Committee Hansard*, 11 September 2002, p. 242.

11 *Committee Hansard*, 11 September 2002, p. 302.

12 *Committee Hansard*, 11 September 2002, p. 268.

13 *Submission 16*, Cbus, p. 8. See also *Submission 29*, AIST, p. 1.

14 *Submission 40*, Cbus, p. 1.

**Table 1: Exit Penalties from Various Superannuation Funds
(Sorted by Penalty as a Percentage of Account Balance)**

Fund	Policy Type	Exit Fee (\$)	Account Balance (\$)	Penalty as a % of Acc Bal
AXA	Personal Superannuation	5,623.79	10,927.96	51.5
FAI	Personal Superannuation	1,227.06	2,537.26	48.4
AXA	Personal Superannuation	5,940.77	18,578.82	32.0
Tower	Personal Superannuation	1,451.29	4,824.77	30.1
AXA	Personal Superannuation	376.27	1,710.32	22.0
AXA	Retirement Security Plan	2,974.12	15,581.14	19.1
AXA	Personal Superannuation	4,859.84	27,639.60	17.6
Norwich	Unbundled Ordinary Policy	2,226.26	12,674.76	17.6
AXA	Retirement Security Plan	1,642.89	10,578.09	15.5
AXA	PruPlan	1,189.90	8,263.04	14.4
MLC	PruPlan	1,189.90	8,263.04	14.4
RSA	Investment Savings Plan	1,939.02	13,943.28	13.9
AXA	Retirement Security Plan	4,982.45	41,369.36	12.0
AXA	Personal Superannuation	1,545.10	16,977.81	9.1
AXA	Personal Superannuation	2,541.59	29,609.42	8.6
AXA	Retirement Security Plan	3,632.53	45,005.68	8.1
AXA	Retirement Security Plan	2,078.97	27,261.52	7.6
Norwich	Personal Superannuation	1,910.98	25,922.57	7.4
AMP	Whole of Life	775.54	12,333.10	6.3
Total		48,108.27	334,001.54	14.4

Source: Submission 40, Cbus, p 4.

8.15 Cbus' call for a prohibition on entry and exit fees was reiterated in hearings by Ms Dyson from AIST,¹⁵ by Mr Silk from the Industry Funds Forum,¹⁶ and Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW. Mr Hajaj observed that currently, consumers are experiencing appalling returns, which suggests that fund managers do not do much besides following what the stock market dictates.¹⁷

8.16 However, various other parties opposed a cap on entry and exit fees. For example, in its written submission, SOS agreed that entry and exit fees effectively stymie choice, but argued that prescribing a cap on fees could deny members access to certain asset classes of their choice.¹⁸

8.17 In evidence on 11 September 2002, Mr Hristodoulidis from the FPA also opposed a cap on entry and exit fees, on the basis that they will be determined by

15 *Committee Hansard*, 3 September 2002, p. 172.

16 *Committee Hansard*, 11 September 2002, p. 269.

17 *Committee Hansard*, 2 September 2002, p. 26.

18 *Submission 4*, SOS, p. 1.

competitive pressures, provided there is adequate education.¹⁹ Mr Gilbert from IFSA²⁰ and Mr Bell from the ABA²¹ presented similar arguments.

8.18 The Committee also notes that it received evidence from some parties claiming that a majority of funds now do not charge entry and exit fees. For example, in the hearing on 2 September 2002, the Committee received evidence from Mr Murphy from the Association of Financial Advisers that he has not seen a fund in the last 10 years that has come on to the market with exit fees. He argued that standard practice is to charge entry fees only.²² Similarly, Mr Gilbert stated that new funds coming on to the market only have entry fees, and not exit fees.²³ In response to this claim, Senator Sherry cited a number of product disclosure statements from current superannuation funds that do charge exit fees.²⁴ The Committee also notes the evidence of Mr Thomas from Treasury that exit fees are still a feature of certain products.²⁵

8.19 In response to this issue, the Committee raised with Mr Thomas from the Treasury during the hearing on 11 September 2002 the possibility of including a cap on entry and exit fees in the Choice Bill. Mr Thomas suggested that a cap would be more appropriately dealt with in the *Financial Services Reform Act 2001* than in the current Bill.²⁶

8.20 The Committee also notes that in its consultation paper on portability, *Portability of Superannuation Benefits*, the Government leaves open the option of regulating fees and charges at a later date:

... the Government must take into consideration the possibility that some funds could use exit fees as a means of countering the introduction of portability. It is for this reason that the Government will reserve the right to regulate exit fees. The Government would only consider regulating exit fees if there was evidence that exit fee arrangements were being structured for the purposes of preventing portability from operating as intended.²⁷

19 *Committee Hansard*, 11 September 2002, p. 226.

20 *Committee Hansard*, 11 September 2002, p. 240.

21 *Committee Hansard*, 11 September 2002, p. 264.

22 *Committee Hansard*, 2 September 2002, p. 37.

23 *Committee Hansard*, 11 September 2002, p. 241.

24 *Committee Hansard*, 11 September 2002, p. 241.

25 *Committee Hansard*, 19 September 2002, p. 310.

26 *Committee Hansard*, 11 September 2002, pp. 297-298.

27 *Portability of Superannuation Benefits: Enhancing the Right of Members to Move Existing Benefits between Superannuation Entities*, Consultation Paper, released by the Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, 19 September 2002, p 16.

Monitoring fees and charges

8.21 A number of witnesses to the inquiry indicated that it would be useful for the Government to monitor fees and charges following the introduction of choice of fund. The Committee notes that the Government has stated its intention to do so. Mr Thomas of the Treasury advised the Committee that the Government will select an ‘appropriate agency’ to undertake the monitoring, although it is unlikely to begin until closer to 1 July 2004.²⁸

8.22 The Committee also notes the recommendation of AIST in its written submission that the Australian Competition and Consumer Commission (ACCC) should oversee fees and charges, perhaps following the Government’s review period.²⁹

28 *Committee Hansard*, 11 September 2002, p. 302-303, *Committee Hansard*, 19 September 2002, p. 324-325.

29 *Submission 29*, AIST, p. 2.

