# Appendix Eight

## IFSA's Supplementary Submission

Investment & Financial Services Association Ltd
ACN 080 744 163

12 August 2003

The Secretary
Senate Select Committee on
Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Mr Frappell

**Reference:**

**Portability of Superannuation – Response to Document Tabled 1 August**

The Investment and Financial Services Association would like to provide the Committee with comments in response to the document tabled at the Melbourne public hearing on 1 August 2003.

The document listed a number of claimed 'exit fees' from retail superannuation funds offered by IFSA member companies. The witness stated that these were actual cases obtained from an organisation known as Industry Funds Financial Practice. IFSA has consulted with the companies named.

There are two very significant errors of fact in the witness' claims.

- The document claims exit fees were levied by at least one fund that does not charge any exit fee, and which has never charged any exit fee.
- The witness asserted "many of the instances I have spoken of … are from modern day master trusts". This claim is not true, so far as we can ascertain from the limited product descriptions in the document.

One fund offered by an IFSA member company is listed in the document as charging an exit fee, although the fund named has never charged and exit fee and does not charge entry fees. The company (Company E) has categorically confirmed that no such fee has ever been charged.

IFSA can find no example in the tabled list of an exit fee levied in master trust open to new members, as the witness appears to have asserted. Critically, the implication that investors who join master trusts now could be levied exit fees of the levels listed in the document is false. There are closed, old-style products where the member has 'traded up' to a master trust environment while retaining the existing contract conditions. IFSA is advised that no new member of a master trust, even where the


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master trust now encompasses these traded-up policies, can face an exit fee such as those claimed in the tabled document.

The witness gave an example of a master trust where holders of old-style products have been included in part of the ongoing master trust through a trade-up process. The original product is no longer sold and no new member joining the master trust would be covered by those fee structures. If this example is the basis of the witness' claim that 'modern day master trusts' have high exit fees, it is incorrect.

In the case of the fund that has never charged exit fees, the amount claimed as an exit fee appears to be a tax amount. If tax is confused with exit fees in this case, we are concerned that other claimed exit fees could include tax.

Given two significant errors of fact, and a possible confusion of exit fees for tax, IFSA is very concerned that the Committee not draw conclusions from this evidence.

The document provides very little detail of the circumstances of the alleged fees and the witness asserted that the amounts listed as 'exit fees' were, or would have been, levied on the stated account balances on exit. The witness described them as 'excessive fees and penalties', and asserted that these were 'mainly comprised of employer contributions mandated by federal parliament'. It appears that both these comments were made in respect of the examples tabled; yet there is simply insufficient detail in the list to determine the basis of the alleged fees and whether in fact they do include mandated employer contributions.

IFSA has not claimed, and is not claiming here, that there may not be circumstances in which significant 'exit fees' can arise. In our original submission, we set out four types of fees that may be referred to as exit fees, including two types of fees in closed products.

- Early termination fees in closed products. These fees were set in superannuation products offered through life insurance offices, and recovered up front costs incurred by the life office. They are often calculated on the first year's premium and reduce over a set period of, say, five years. The proportionate impact of these fees also reduces the longer a product is held because the first year's premium becomes a smaller and smaller proportion of the balance.
- Early termination of contract (traditional policies – whole of life, endowment or pure endowment). Traditional policies were structured on a long-term basis usually comprising an investment and, in earlier years, an insurance component. The contracts operated on the basis of a guaranteed maturity value at a date in the future. Up front costs were incurred meaning that in the first few years of operation, the surrender/cash value of the policy was nil, or significantly less that what had been paid in. Defaulting on the contractual terms would create a significant gap between what would have been paid, both as a guarantee and in bonuses, had the contract run to maturity. Provided that clients have met the conditions of the contract, most traditional super policies have probably been in force for so long that this position no longer applies. These contracts were formulated in a very different environment and, given their long-term structure, do not suit early withdrawal or partial cashing


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(although bonuses may generally be taken early). These contracts are no longer offered.

I have attached comments made by five of the companies named in the tabled list. For commercial confidentiality, these remarks do not identify particular companies or products.

It is unfortunate that the committee has made a decision to release the material without first verifying all of the facts. There has already been newspaper reportage quoting extracts from the document. The document tabled contains errors of fact, which if published, could cause commercial damage.

Yours sincerely

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Chief Executive Officer



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**Comment on Tabled Document: Company A**

The names on the list are not all product names but generic descriptions. The company cannot identify the specific products from these descriptions.

All products of this type have been closed for new member sale.

The products were designed as long term investments to be held to long term retirement. The exit fee is only paid if the contract is broken early.

Each contract had a target duration from the outset. This was the date by which the exit fee would reduce to zero

As these are longer term investments the design was to spread the costs over a longer period

The general structure of the termination fees was that they reduced as contributions were paid and the savings built over the life of the superannuation policy.

An exit fee might arise if the member broke the contract early and the earlier that happened in the contract term the larger the fee would tend to be.

Where a person stopped paying contributions the exit fee would no longer reduce as quickly as planned.


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**Comment on Tabled Document: Company B**

Without further information the company cannot investigate the specific circumstances surrounding the examples outlined, however, it appears that the accounts referred to are older style superannuation policies. This kind of superannuation savings policy was standard in the 1980's and early 1990's across the financial services market.

During this time, superannuation policies were designed as long-term savings policies where the investor's funds were committed to a single provider until retirement. This involved a mutually agreed long-term contract and reflected superannuation industry practice at the time. Generally, these policies remain viable retirement savings vehicles for investors who continue to contribute to these accounts for the duration of the contract.

The company can confirm that it has not issued accounts of this nature since the mid 1990's. The company supports the transparent disclosure of fees to investors and allowing investors to move their funds at any time.


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## Comment on Tabled Document: Company C

The list of products presented to the Committee included a product issued by a former life office during the period commencing in the late-1980s up to the close of the product in May 1999. The illustration shows that the exit fee amounted to 32% of the account balance. The information provided by the Committee was insufficient to verify the accuracy of the exit fee ratio. The structure of the product allowed for a variety of distribution conditions and some included high distribution/advising costs recouped through high exit fees on surrender at short durations.

## Exit Fees versus Entry Fees

The product design offered exit fees as a replacement for entry fees. Generally, all savings based products carried fees to cover the cost of distribution. Products with exit fees did not carry any particular bias in pricing compared to products structured with entry fees. Some policyholders who had early surrenders on the entry fees products would have paid similar distribution costs to the case illustrated in the Committee's evidence.

## Upfront Expenses on Long-Term Products

During the decades of 1980-90, personal superannuation products were sold as long-term savings vehicles. When the up-front high distribution costs were spread over the contractual term, the expense loading appeared reasonable (in terms of the values of the day). The unreasonable nature of the charge was crystallised when the policyholder exercised options to surrender the policy before the contractual period had been completed. There are policyholders who will continue to pay the premiums on their policies and who will be satisfied with the distribution charges collected over the full contractual term.

## Product Disclosure Standards

The industry and regulator participated in developing compliance requirements for disclosure of fees and charges in the 1980-90s. The foundation for disclosure requirements now enforced through FSRA was laid during this period. During that period the product brochures kept pace the rapidly evolving disclosure requirements. the adjustments to reflect collectible unamortised exit fees.


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## Comment on Tabled Document: Company D

### Product pricing structure

This product is a regular premium personal superannuation product that was developed in the 1970s as a long-term savings plan to provide financial security for members in retirement. The fee structure is not unique, it is similar to the fee structures of products offered by other financial services companies at the time it was developed and sold.

The product was designed to reward members who commence their contributions at an early age and continue these through to their Selected Retirement Date (SRD). If the member stays in the plan until their SRD, no exit penalties are charged and the member benefits from a fee structure that declines as the savings accumulate. The ongoing fees and charges for a contributing member are generally a lot lower than many other products currently on the market, over the life of the policy.

Contributions are paid into the client's account. The Basic Account receives the first two years of contributions (and the first two years of any increase in contributions), while the Investment Account receives all contributions made in the third and subsequent years as well as any single, one-off contributions or additions.

The charging structure is such that the upfront expenses incurred in establishing a contract are not deducted as a one-off establishment charge. Rather, they are deducted using the Basic Account management charge over the term of the contract to the SRD.

As stated previously, members are rewarded through lower management charges as savings accumulate. The account management charges are as follows:

**Table 1**

| | Basic Account Charge | Investment Account Charge |
|---|---|---|
| Total Account balance < $20,000 | 3% pa | 0.5% pa |
| Total Account balance $20,001 - $40,000 | 2.75% pa | 0.375% pa |
| Total Account balance $40,001 + | 2.5% pa | 0.25% pa |

In addition to the account management charge (basic account charge and investment account charge), an asset management fee is deducted before our unit prices are set on the underlying portfolios. This asset fee is 1.15% pa for the Guaranteed and Managed portfolios, 1.20% pa for the Growth portfolio and 1.25% pa for the High Growth portfolio. An additional charge of 0.6% pa applies on the Guaranteed portfolio to cover the costs associated with providing the capital guarantee.

For ongoing contributions (ie after the first two years), the maximum charge (including the account management charge and asset management charge) for members in the Managed portfolio (the majority of members) is 1.65% pa. This reduces to 1.40% pa for members with an account balance that exceeds $40,000:

### Exit Fee

The charging structure is designed so that the fees are distributed over the expected life of the plan, rather than as a high establishment cost. The exit fee is in place to recover the initial costs associated with commencing the plan as a lump sum should the length of the contract be reduced. The fee is calculated as follows:


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The balance of the Basic Account is discounted by a given factor for each year remaining to the Selected Retirement Date (or part thereof). The factor applied is relative to the size of the Basic Account Balance as follows:

**Table 2**

| Basic Account Balance | Exit Fee |
|---|---|
| <$10,000 | 4% x Basic Account Balance x Years to SRD |
| $10,001 - $20,000 | 3.5% x Basic Account Balance x Years to SRD |
| $20,001 + | 3% x Basic Account Balance x Years to SRD |

This product was designed 20 years ago in a way that was consistent with the products offered by other retail superannuation providers at that time with the aim of encouraging people to save for their retirement. However, customer requirements have changed over time, and the market now demands more flexibility. Products on sale now are designed and priced to offer flexibility in the early years, rather than being focused purely on the value at retirement.

**Recent Improvements**

In recognising this trend, the company has implemented a number of changes to modernise the contract and review the investment options available under the contract, in an effort to improve our members' benefits.

The company undertook extensive independent market research to produce a package of changes which overall improve member benefits. The charging structure was revised in July 2001 so that all future contributions (including the first two years of any increase in contributions) are allocated to the lower cost Investment Account. This also ensures that any future increase in contributions is not considered in the exit fee calculation (which is a proportion of the Basic Account balance). The company also introduced additional investment portfolios to cater for all risk profiles. These changes were a significant investment for the company and were aimed at improving member benefits and retaining these clients in the product.

Using the market research the company also designed a conversion offer to its on-sale products. This initiative was included in recognition of those clients who are after more extensive investment options than available in the newly improved product. This conversion offer effectively grandfathers 5% of this product's exit fee in the new products.

The company has made significant changes to this product and believes these changes make it a very competitive product in the retail superannuation market. This product will not always be suitable for the needs of all members and in these circumstances alternative products may need to be considered.

The company believes that this product is now a viable investment to be retained by members as part of an overall portfolio of diversified asset classes and products. It is one of the only products in the retail superannuation market that offers a Capital Guaranteed portfolio to members, which can be an attractive option when market returns fall.


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**Comment on Tabled Document: Company E**

**Superannuation fund**

The superannuation fund is a nil-entry fee, nil-exit fee fund used widely by investors and advisers. It currently has almost 27,000 members in the fund.

The superannuation fund does not charge entry or exit fees. The fund has been in operation since November 1984, initially as an approved deposit fund which now operates as a superannuation fund under SIS. At no time has the trust deed allowed the trustee to charge an exit fee. The fund can deduct amounts for reimbursement of taxes paid, in addition to annual management and expense recovery fees. All fees and taxes have been clearly disclosed in the offer documents and annual reports for the fund.

Although we do not know the facts of this particular case, we can only assume that what appears more likely to be a taxation liability has been incorrectly characterised as an exit fee.


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