Chapter Seven

Exit Fees

Introduction

7.1 This chapter examines three issues in relation to exit fees levied on superannuation funds in Australia:

a) Whether exit fees are a barrier to portability;

b) Whether a cap or ban should be placed on exit fees; and

c) The Government's position on exit fees.

A barrier to portability?

7.2 The application of exit fees, their level, and whether they pose a barrier to portability, attracted considerable comment and debate during the conduct of the inquiry.

7.3 For example, in its written submission, the ACA argued that exit fees are a true barrier to portability, and that their presence in the superannuation sector undermines any attempts to introduce greater mobility among consumers.[1]

7.4 Similarly, in its written submission, IFF argued that exit fees can act as a major obstacle to members seeking to roll over/transfer their superannuation, and cited the examples in Table 7.1 below of the cost of rolling over/transferring an amount from a non-industry fund to an active industry fund account.

Table 7.1: Exit Fees/Penalties cited by IFF

Account Balance	Exit Fee/Penalty	Per cent
$5,939.14	$5,621.11	95
$1,287.80	$1,195.27	93
$11,223.08	$8,211.53	73
$21,694.00	$6,090.67	28
$216,705.36	$40,595.40	19

Source: Submission 4, IFF, p. 2.

1 *Submission* 32, ACA, p. 3.

7.5 In its written submission, IFF argued that many people refuse to incur costs such as those listed in Table 7.1 above, and thus retain their money in their existing accounts.[2]

7.6 In its written submission, Cbus also indicated that it has identified withdrawal fees of up to $5,940 or 32 per cent of the balance of a fund for one of its members who wished to consolidate his or her account with Cbus.[3] Accordingly, Cbus also argued that the existence of significant exit fees acts as a barrier to competition.[4]

7.7 In response to such concerns, the Committee notes that IFSA made a detailed submission. IFSA argued that exit fees essentially fall into four broad categories:

a) Recovery of administration costs. IFSA indicated that completing a roll over/transfer requires significant administration to ensure that the roll over/transfer has been successful, that the receiving fund is a complying fund, that it will accept the roll over/transfer and so on. The fee is usually a fixed dollar fee.

b) Deferred entry fees. IFSA indicated that in some products, the investor may choose not to pay an entry fee, and instead to pay higher ongoing fees. The product provider pays the advice fee to the adviser up-front, and a reducing exit fee applies to recover the balance of the commission should the investor leave the fund within a set period, for example five years.

c) Early termination fees in closed products. IFSA indicated that these fees were used in superannuation products offered through life insurance offices to recover up-front costs by the life office. They were often calculated on the first year's premium and reduced over a set period of, say, five years.

d) Early termination of contract fees. IFSA indicated that traditional policies such as those offered during the 1980s were structured on a long-term basis, and included significant early termination fees or adjustments for early termination of contract.[5]

7.8 In relation to each of these categories of exit fees, IFSA argued that they no longer constitute barriers to members seeking to roll over/transfer their superannuation:

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2 *Submission* 4, IFF, p. 3.

3 *Submission* 16, Cbus, p. 3.

4 *Submission* 16, Cbus, p. 3.

5 *Submission* 21, IFF, pp. 3-4.

a) Recovery of administration costs: IFSA argued that these fees, which simply meet administrative and transaction costs, do not represent a barrier to exit. Indeed, it would be inequitable to subsidise such fees by charging the remaining members of the fund.

b) Deferred entry fees: IFSA argued that as deferred entry fees are generally flexible (investors can choose the structure they prefer) and reduce to zero over a period of up to five years, they do not represent a significant barrier to portability.

c) Early termination fee products: IFSA argued that products enforcing early termination fees were commonly offered during the 1980s, but that the life insurance industry has moved away from offering such products. IFSA argued that they constitute less than 5 per cent of all retail and master trust funds under management.

7.9 Accordingly, IFSA argued that exit fees do not represent a significant barrier to portability of superannuation accounts, and that a compelling case has not been made to regulate exit fees.[6]

7.10 Mr Gilbert from IFSA reiterated these arguments in the hearing on 31 July 2003, and further argued that the introduction of a competitive portability and choice environment would prevent products with high exit fees ever being offered in the future. In the past, Mr Gilbert suggested that many people offered products with high exit fees never had a choice about where the money went – it was directed to a particular fund by their employer.[7]

7.11 The above evidence of IFSA was reiterated by the ABA[8] and the FPA. The FPA additionally suggested that 'high' exit fees often reflect acquisition costs which have already been met and are recovered over the life of a contract. In addition, the FPA also submitted that making retrospective changes to existing contracts/agreements would have a major negative financial impact on the providing fund or sponsor.[9]

7.12 The Committee also notes that in the hearing on 1 August 2003, Mr Ward from Mercer indicated that in the hundreds of funds that Mercer administers, he is not aware of any that charge excessive exit fees. He noted that in some cases, the cost of realising the assets (sometimes up to 20 per cent) might be passed on to the member, and that that cost might be interpreted as an exit fee, however in practice it is not.[10]

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6 *Submission* 21, IFSA, pp. 3-4.

7 *Committee Hansard*, 31 July 2003, p. 29.

8 *Submission* 29, ABA, p 3.

9 *Submission* 24, FPA, p. 2.

10 *Committee Hansard*, 1 August 2003, pp. 26, 31.

7.13 In the hearing on 1 August 2003, the Committee raised with Mr Silk from IFF the argument of IFSA that the incidence of 'old-style' life company type superannuation products was declining. Mr Silk responded as follows:

> I understood that was put to the committee yesterday. In fact, I contacted Industry Funds Financial Practice this morning before this hearing to put that to them. They said that is certainly not the case. Certainly endowment policies are reducing as a proportion of policies in the community, but many of the instances that I have spoken of—and I have got pages of other examples here with similar amounts of money and similar percentage fees—are from modern day master trusts by many very well-known providers of master trust products. So, first, it is not a small problem. Second, it is not confined to endowment type policies. Third, it is a feature of large master trust products that are promoted by many of the industry's biggest players.[11]

Tabled document on exit fees

7.14 The Committee notes that further to the arguments about the level of exit fees outlined above, Mr Silk from IFF tabled in the hearing on 1 August 2003 a large number of further examples of exit fees/penalties (including those listed in Table 7.1 above). The tabled document is reproduced in **Appendix Seven**. Mr Silk obtained the figures from Industry Funds Financial Practice, which is an organisation which provides financial planning advice to members of industry superannuation funds.[12]

7.15 As shown in **Appendix Seven**, Industry Funds Financial Practice listed a large number of retail superannuation funds which it claimed levied exit fees of up to 95 per cent.

7.16 The Committee subsequently received a supplementary submission from IFSA responding to the document tabled by Mr Silk, and the claim of exit fees of up to 95 per cent. Based on consultation with the companies involved, IFSA argued that the document tabled by Mr Silk contained two significant errors.

7.17 Firstly, the tabled document claimed exit fees were levied by at least one fund that does not charge any exit fee, and which had never charged any exit fee.

7.18 Secondly, the funds referred to were not modern day master trusts as asserted by Mr Silk. IFSA commented as follows:

> IFSA can find no example in the tabled list of an exit fee levied in master trusts 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

11 *Committee Hansard*, 1 August 2003, p. 5.

12 *Committee Hansard*, 1 August 2003, p. 4.

> advised that no new member of a master trust, even where the master trust now encompasses these traded-up policies, can face an exit fee such as those claimed in the tabled document.[13]

7.19 Based on these two arguments, and possibly confusion of exit fees for tax by the Industry Funds Financial Practice, IFSA argued that the Committee should draw no conclusions from the document tabled by Mr Silk.[14]

7.20 For completeness of the record, the Committee publishes the supplementary submission of IFSA in response to the document tabled by Mr Silk in **Appendix Eight**.

7.21 In turn, the Committee also received a supplementary written submission from IFF in which it stood by its tabled document.[15] The IFF's supplementary submission was prepared for IFF by Industry Funds Financial Planning (IFFP), and analysed the recommendations made by the IFFP Rollover Service concerning exit penalties charged by other funds for the period 1 July 2001 to 30 June 2003.

7.22 The IFFP found that from 1 July 2001 to 30 June 2003, the Rollover Service produced a total of 2310 recommendations:

- Of the 2310 recommendations, 387 (16.8 per cent) were recommendations not to roll over. Of those 387 recommendations:
  - 194 were due to exit penalties. The total value of exit penalties was $747,994, or 19 per cent of the corresponding account balances of $3.9 million.
  - 193 were due to issues other than exit penalties.
- Of the 2310 recommendations, 1923 (83.2 per cent) were recommendation to roll over, of which 1196 involved no exit penalty and 727 (37.8 per cent of all roll over overs) involved an exit penalty.
  - Of the 727 recommendations to roll over despite an exit penalty, the total value of exit penalties was $626,982 or 34.5 per cent of the value of the corresponding total account balance ($18.2 million).

7.23 Again, for completeness of the record, the Committee published the supplementary submission of IFF in **Appendix Nine**.

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13 *Submission* 30, IFSA, pp. 1-2.

14 *Submission* 30, IFSA, p. 2.

15 The original submission was received 14 August 2003. The Committee subsequently received additional supplementary material by post on the 18 August 2003.

A cap or ban on exit fees?

7.24 A large number of parties to the inquiry advocated that a cap be placed on exit fees on mandated superannuation products at a level sufficient to cover actual expenses to a fund from a roll over/transfer. To cite the ACA submission:

> In ACA's view, if the industry cannot evolve to abolish these fees, there is a strong case for Government intervention. Australian consumers do not have a choice about contributing to superannuation – it is mandated by government, and if they are to be given the power to exercise greater control over the location of their superannuation, they should not be fined for doing so.[16]

7.25 This position was expressed by SOS,[17] AIG,[18] the Corporate Super Association,[19] the ACTU,[20] AIST[21] and IFF.[22]

7.26 Importantly, however, the Committee notes that in its written submission, Mercer specifically rejected an outright ban on exit fees. Mercer argued that the additional costs associated with portability will generally be recouped by charging an exit fee to members who elect to roll over/transfer benefits. If an exit fee is not charged, Mercer noted that this would lead to other members subsidising the costs of the transferring members, which would be inequitable. [23]

7.27 This position was reiterated by Mr Smith from the Queensland Local Government Superannuation in the hearing on 31 July 2003:

> … the people that want to have the portability should be bearing that additional cost in some shape or form and that as much as possible the people that stay with the fund long term should not bear a disproportionate share of that cost.[24]

7.28 The Committee also noted evidence from the hearings that any cap on exit fees to, say, the cost of processing, would have to be prospective rather than retrospective.[25]

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16 *Submission* 32, ACA, p. 3.

17 *Submission* 19, SOS, p. 1.

18 *Submission* 5, AIG, p. 1.

19 *Submission* 9, Corporate Super Association, p. 5.

20 *Submission* 10, ACTU, p. 1.

21 *Submission* 11, AIST, p. 2.

22 *Submission* 4, IFF, p. 3.

23 *Submission* 17, Mercer, p. 3.

24 *Committee Hansard*, 31 July 2003, p. 48.

25 *Committee Hansard*, 31 July 2003, p. 23. *Committee Hansard*, 1 August 2003, p. 6.

7.29 In the hearing of 1 August 2003, Mr Ward from Mercer, which administers hundreds of funds, suggested that the real cost of providing a roll over/transfer is probably greater than $100 but less than $200.

7.30 In response to these arguments, IFSA suggested that regulation of exit fees would be counter productive from a competition, choice and consumer design perspective. If a cap was placed on fees, IFSA argued that fees would tend to rise to match the level of the cap.[26]

The Government's position

7.31 The Committee raised the issue of exit fees with officers of Treasury in the hearing on 13 August 2003.

7.32 In his evidence, Mr Rosser from Treasury acknowledged that in some circumstances, depending on the level of the fee, exit fees can constitute a barrier to portability. However, Mr Murray argued that the Government cannot retrospectively address exit fees in a contract that individuals have entered into.[27] In addition, Mr Murray argued that if exit fees were banned, it may well be that the exit fee cost would simply be translated into an additional annual administration cost which all members of the fund would bear, instead of the member exiting the fund.

7.33 Rather, Mr Murray expressed the Government's position on exit fees as follows:

> …the government's view is that the actual competition that will flow from portability will ensure that funds in future will not be charging high exit fees. They will not attract new members if they do.[28]

7.34 In its written submission, APRA also suggested that the introduction of portability may foster competition in the industry by forcing funds to be more sensitive towards fee structures and investment performance.[29]

7.35 In response to the stated Government position on exit fees, Senator Sherry argued that if fund trustees wanted to keep members and their superannuation savings within the fund, then the logical thing for the trustees to do would be to introduce a high exit fee. This would be especially attractive to some fund trustees who are presently guaranteed a certain employer contribution, such as funds under state awards.[30]

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26 *Submission* 21, IFSA, pp. 3-4.

27 *Committee Hansard*, 13 August 2003, p. 26.

28 *Committee Hansard*, 13 August 2003, p. 25.

29 *Submission* 14, APRA, p. 3.

30 *Committee Hansard*, 13 August 2003, pp. 26-28.

7.36 In reply, Mr Murray and Mr Rosser from Treasury acknowledged that there would be no legislative restriction on trustees placing high exit fees to prevent roll overs/transfers, but that they would have difficulty attracting new members. Mr Rosser suggested that fund trustees would be unlikely to effectively close their fund through a high exit fee in a competitive environment.[31]

7.37 The Committee notes that in its September 2002 consultation paper, Treasury indicated that the Government's preference is to allow funds to develop their own fee structures, but that the Government would reserve the right to regulate exit fees if this appeared necessary to ensure the effectiveness of portability.[32]

31 *Committee Hansard*, 13 August 2003, pp. 26-27.

32 Commonwealth Treasury, *Portability of Superannuation Benefits*, p. 16. *Committee Hansard*, 13 August 2003, p. 28.