Senate Select Committee on Superannuation and Financial Services

Main Inquiry
Reference (a)

Submission No. 45

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Senate Superannuation & Financial Services Committee

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9 June 2000

Sue Morton
Secretary
Select Committee on Superannuation and Financial Services
Department of the Senate
Room SG 64
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

Submission to Main Inquiry

Please find enclosed a submission made by Industry Fund Services Pty Ltd in relation to the Main Inquiry into superannuation and financial services.

I would appreciate it if I could be advised when this submission has been accepted by the Committee.

Should you have any queries, please direct them to the Business Manager at IFS, Robbie Campo, on 03 9657 4321.

Yours sincerely

Sandy Grant
GENERAL MANAGER

encl.

INDUSTRY FUND SERVICES

SUBMISSION BY
INDUSTRY FUND SERVICES PTY LTD
TO THE SENATE SELECT COMMITTEE ON
SUPERANNUATIONAND FINANCIAL SERVICES

MAIN INQUIRY

9 JUNE 2000

Introduction

Industry Fund Services Pty Ltd ("IFS") would like to thank the Committee for the opportunity to submit a submission at this late stage of the inquiry. IFS decided to make a submission in order to correct a number of errors made in the oral evidence of Mr Michael Rice given on 15 May 2000.

Our submission will rectify the factual errors made by Mr Rice, and will briefly address the first term of reference of the main inquiry, namely, "*prudential supervision and consumer protection for superannuation, banking and financial services*".

Incorrect statements made by Michael Rice

In order to understand the evidence given by Mr Michael Rice of Phillips Fox Actuaries, it is necessary to understand where he fits into the superannuation market. Mr Rice is a highly experienced superannuation practitioner. Mr Rice has been a frequent critic of industry superannuation funds. As one of the most vocal and frequent supporters of the master trust style of provision upon which he has built a very successful business, it was no surprise to note that he had presented such a strongly pro- master trust position in his submission and evidence.

We consider Mr Rice's evidence to be an abuse of parliamentary privilege, because it is misleading and without factual basis, and obfuscates the issue of commissions to the detriment of the reputation of IFS, Bernie Fraser and industry superannuation funds. In particular, Mr Rice's evidence implies that industry funds were involved in paying "secret commissions", which carries criminal connotations, and if repeated elsewhere would certainly result in legal action.

Mr Rice gave the following oral evidence to the Committee on 15 May 2000.

> "**Mr Rice**- CLERP 6 should deal with it, I am not sure that CLERP 6 has yet determined what to do with non-profit funds. I think they are waiting to see what happens with choice of fund. They have indicated that super funds should follow the CLERP 6 recommendations or legislation, but at the moment I think an industry fund that is not a public fund offer, a public sector fund or a corporate fund perhaps need not follow.
>
> On the subject of commission, this is perhaps even more emotive. People can argue that commission is a corruptible system because the amount of work done bears no relation to the income. In some cases that is true. One of the difficulties, though, is that, in a group situation where a financial planner, broker or agent is giving advice, they can be giving advice to the trustee, the employer and to the members or collectively on behalf of the members. It is very difficult for them to be paid other than through the income stream of the fund itself. I would have no problem if commission were outlawed because it would force employers to pay those people direct, but many employers might say, 'We're not prepared to pay more than the SG', and you could run the risk that those people then will not get advice.
>
> There are a lot of secret commissions in the industry as well. Bernie Fraser says on television that there are no commissions paid and yet three out of the six funds he represents pay a percentage of the group life premiums to an ISFA brokerage (sic). It might only be two per cent of premiums but when you are paying premiums of millions of dollars a year you can have hundreds of thousand of dollars flowing through in commission.
>
> **Senator CONROY**- Did you consider referring that to the ACCC as false and misleading?
>
> **Mr Rice** - I do not think it is at the moment. Commissions on risk business do not have to be disclosed. I was not trying to single that one out, I was trying to show you how even in a squeaky clean case it is not always as clean as it is looks. Master trusts often supplement their adviser's income by paying commissions of up to 20 per cent on the group life premiums as well, and they remain undisclosed because they do not need to be disclosed. Under CLERP they will be, but only for those public offer funds.
>
> I have a son who left an industry fund to join another industry fund as an experiment I exercised the continuation option where he could take the death benefits across to a retail product. He was paying a dollar a week for insurance. His benefit was probably only $35,000. When the application came to him we filled it out and lo and behold we received an application from ACNL, a subsidiary of AXA. It had a $75 policy fee and a premium of whatever it was which took it up to $120 or $130 a year, significantly more than he was paying. And again in that case, even though it was an industry fund, if he had exercised it that company would have paid commission back to the industry fund as a lead.
>
> I personally do not think there is anything wrong with that. It is remunerating them for the work they have to do. I just wanted to show that commission is not as easy as it sounds.
>
> **Senator CONROY**- So you are saying disclosure is best on all fronts?
>
> **Mr Rice**-Exactly" (SFS84, 15 May 2000)

Mr Rice's evidence contained the following errors:

- The Bernie Fraser campaign involves five, not six, industry superannuation funds.

- Four, not three, of the industry superannuation funds take insurance broking services from IFS Insurance Broking Pty Ltd. The broking services provided by IFS Insurance Broking Pty Ltd have massively reduced the premiums paid by our clients for group risk insurance.

- None, not three, of the industry superannuation funds pay a commission to IFS Insurance Broking Pty Ltd – three pay on an hourly consultation fee basis, for the other, IFS Insurance Broking Pty Ltd receives compensation directly from the insurer, as this was the client's preferred method of payment.

- Industry funds do not receive commissions when insurance extensions are effected.

- There are no secret commissions paid by industry super funds to IFS, IFS Insurance Broking Pty Ltd or to any other entity, or received by industry superannuation funds from any entity.

That such an experienced person as Mr Rice could make misstatements of fact on such simple basic matters, all of them easily verifiable, is puzzling. Even more puzzling is his implied proposition that payment received for the process of designing, tendering and negotiating the range of insurance benefits to be made available through a superannuation fund can be equated with the sale of membership of a fund to an individual member by a commission agent. The scale and the very nature of the two transactions are so different as to make the analogy quite ridiculous.

Sales commissions, which are the type of payments objected to by industry funds, are a percentage based fee paid to an agent, an "independent" financial advisor, accountant or other person, for convincing a consumer to have their superannuation paid into a particular supernnuation fund. Industry funds, which are not-for-profit, do not pay sales commissions to agents or others for inducing consumers into their fund. It is very important to understand that the sales commissions paid by master funds in the retail financial services market are entirely different in nature to other fee structures which operate in a wholesale environment, such as percentage based fees for funds management or group insurance, or brokerage on shares transactions. It is inappropriate to compare the two arrangements.

It is beyond belief that Mr Rice's presentation is merely a coincidental succession of simple errors. It appears much more likely to be an attempt to justify the payment of agents' commissions by master funds and other superannuation fund promoters on SG contributions. Industry funds (and their sponsoring organisations) strongly oppose the payment of commissions on a compulsory (regulated by government) payment. It is totally inappropriate. Industry funds have no opposition to commissions being paid on voluntary superannuation contributions - provided they are adequately disclosed – on the basis that the commission agent has a reasonable case to say that they have persuaded the individual to make the contributions. However, it is our view that commission selling should be proscribed in relation to compulsory superannuation payments. Mr Rice's evidence was, in our view, a mischievous attempt to deliberately cloud the issue of the payment of agents' commissions from the compulsory superannuation contributions of consumers.

The impact of sales commissions on retirement savings, in combination with other fees and charges

We believe that a major focus for this inquiry, insofar as it relates to consumer protection, should be on such commission agents who advise and promote consumers to put their superannuation into a fund from which the agent receives a commission. It is very difficult for the average consumer to adequately discern the impact that such commissions will have on their ultimate savings, especially when combined with other fees and charges.

The impact of the payment of commissions on the level of fees imposed by master trust promoters (and others employing commission agents) is very significant. Commission agents employed in the "for profit" industry are remunerated in two ways – by an up-front payment made at the time a member is enrolled, and by trailing commissions paid each year of ongoing membership. Although there has been a lot of adverse publicity about the up-front commissions, they are still paid, albeit at the lower rate than was often the case in the past (in some cases up-front commissions were as high as 180% of the contributions in the first year but are typically now in the range of 5% - 30% of contributions in the first year). At the same time trail commissions have been introduced, which vary between a range of .2% and 1% per annum.

The adverse publicity surrounding up-front commissions about the level of fees and charges the master trusts are paying has prompted fund promoters to introduce the concept of 'back-end fees', which are used to deceive consumers into believing that they are paying a lower commission. Instead of illustrating the impact of a commission induced fee structure in the member's savings in the early years of membership, master trusts introduce concepts like 'establishment units' or 'establishment accounts' which are represented to be part of the member's entitlement.

These establishment arrangements are characterised by two features:

(i) they earn no or substantially lower returns than the remainder of the member's investment;

(ii) should the member cease contributions or transfer to another fund the establishment units or accounts are forfeited.

The negative impact of (i) on the member's entitlement is reasonably obvious. The impact of (ii) is a little more subtle – it becomes a major deterrent to members moving between funds in search of better outcomes. It is indeed ironic that Mr Rice can defend the practice of charging sales commissions. As the Managing Director of Phillips Fox Actuaries and Consultants, Mr Rice has a long standing business association with David Connelly, and has been an ardent promoter of the "Choice of

Fund" policy. High back-end commissions and charges are at odds with, and have the potential to significantly undermine, the free movement of consumers between funds were "Choice of Fund" to be introduced.

Commissions are recovered through a range of other fees and charges which apply to the superannuation accounts.

Broadly speaking, there are four types of fees:

(i) Administration fees deducted from contributions as they are made – and can be either a fixed dollar sum per week/month or a percentage of the actual contribution, or both.

(ii) Trustee fees – to cover the expenses incurred by the trustee of the fund, be it a master trust, corporate fund or industry super fund. Typically master trusts charge a fixed percentage fee within which they meet the costs incurred and secure their profits while the not-for-profit sector calculates the actual costs incurred and recovers them.

(iii) Funds Management Fee – the fees levied by the actual managers of the funds investments.

(iv) Specific activity fees – for such activities as exiting a fund and switching between investment options. Since these fees are more discretionary in nature we will omit them from the following analysis.

Table 1 demonstrates the impact which differing administration fees have on the account balances of superannuation accounts. The calculations demonstrate that fees which are charged on the entire balance of an account have a greater impact than flat administration charges or fees on contributions. An annual 2% fee alone would absorb nearly a third of an account balance over a working life of thirty years.

TABLE 1

IMPACT OF ADMIN FEE STRUCTURES

Assume
* 30 years in fund
* Salary $35,000 zero inflation
* Contributions - 9%
*Earning rate of fund - 8%

Zero fees	**$1.00 pw**	**5% of all contributions**	**Asset fee - P A**			
			0.5	1.0	1.5	2.0
$	$	$	$	$	$	$
340,592	334,950	323,563	308,341	279,406	253,440	230,129

Note: The gap between contribution based fees and asset fees grow even wider if:

1. the base salary is escalated by an inflation factor;
2. the base salary level is higher than $35,000;
3. contributions are higher than 9% of salary;
4. earning rates are higher than 8%

Attachment A sets out various tables which also demonstrate the effect which various fees have when they are applied in combination. Option one is a hypothetical set of numbers which compares the member's benefit where their account can be managed without incurring any costs. Option two demonstrates the impact of fees and charges at a level which are typical of industry superannuation funds. Options three and four demonstrate the effect of fees and charges typically imposed by master funds.

We have provided, in Attachment B, a summary table illustrating the fee structures of high profile master trusts (as taken from their Key Feature Statements) which are included to illustrate that the fee/cost assumptions that we rely on in Attachment A are realistic.

The level and nature of disclosure required for adequate consumer protection

The comparisons provided above demonstrate the inadequacy of the present and proposed disclosure regimes. Even in a regulatory environment in which a promoter is required to advise a consumer of the quantum of fees levied on their savings, there would still not be any disclosure of the impact of those fees on the consumer's ultimate retirement benefits. If the consumer is an average person, it is unlikely that they will be able to translate the quantum of fees into an understanding of the amount they will be paying in commission and other fees and the impact these fees will have on their ultimate retirement benefits. For example, the average person is likely to believe that a fee of "5% of all contributions ever paid into their superannuation fund" is more disadvantageous than "1% off the top of their fund earnings each year". In fact, the second fee has a far greater impact on the end benefits, as was shown in Table 1 – especially given that the 1% is payable whether or not the fund actually earns a positive return!

Disclosure must be structured to allow people to make informed decisions and the best way to achieve that is to ensure that people are clearly shown the impact of the fee structure of a fund on their savings, and not simply told the quantum of the fees and charges. It should be the responsibility of the fund promoters to provide that data, not of the potential member to calculate the likely impact from the confusion of numbers and convoluted marketing speak contained in brochures.

IFS believes that for the public to be able to make valid comparisons and to be able to compare like with like, there needs to be a prescriptive approach to disclosure of fees and charges. Given the forecasting technology which is now available, a promoter should be required to produce a simple comparison of the outcome of a member investing a given amount each year, assuming certain inflation and funds earnings rates in its fund and applying its fees and charges, against the outcome where there are no fees and charges. An example of the type of disclosure regime which in our view would be more informative for the average consumer is set out in Attachment C. In Attachment C there are three examples, the first being a blank pro-forma disclosure document, the other two setting out the cumulative effect of the fees typical of a master fund and an industry superannuation fund. It demonstrates the very significant cumulative effect of the different fee structures over the period of a working life.

If all funds followed the same practice using the same (prescribed) assumptions, then the public would be able to compare the impact of the fee structures very easily. If each fund were required to complete a disclosure document of this nature, consumers who were considering a fund could easily and quickly assess the relative impact of the different fee structures on their retirement savings.

Conclusion

It is an enormously difficult task to establish a regulatory system which will enable proper and adequate disclosure for consumers in the financial services market. The concepts involved in financial markets are inherently complicated, and easily able to be distorted to conceal the true impact of fees and charges, especially where a promoter has a vested interest in selling the product by virtue of the commission they will receive.

Indeed, we believe that as Mr Rice has demonstrated by his evidence, it is easy for an individual to confuse issues to suit their own purposes. Many consumers do not have the resources, knowledge base or education which would enable them to understand the fees, charges and commissions which impact on their superannuation savings. It is imperative in our view that disclosure regimes guarantee that consumers are provided with information about *the impact* of fees and charges so that they can make a more informed decision about the future of their retirement savings.

We are available to give further oral evidence should that be of assistance to the Committee.

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Sandy Grant
GENERAL MANAGER

ATTACHMENT A

Summary Table of Different Fee Structures

Summary Table

Assume:

- Member Earns $35,000pa
- Contributions - 9% of earnings
- Fund Earning Rate (FER) - 6%
- Wage Inflation Rate (WIR) - 3%
- Fee Structure;

  Option 1: Nil
  Option 2: $1.00 pw + 0.5% of assets
  Option 3: $1.00 pw + 5.0% of contribution and 1.0% of Assets
  Option 4: 5% of contribution + 1.5% of assets

	OPTIONS ($)			
Years to Retirement	1	2	3	4
10	41,085	39,147	36,104	35,823
15	77,090	72,439	65,898	64,509
20	128,793	119,288	106,994	103,298
25	202,065	184,374	162,977	155,133
30	304,853	273,887	238,495	223,744
35	447,891	396,007	339,553	313,856
40	645,669	561,529	473,902	431,439
45	917,714	784,670	651,534	584,028

ATTACHMENT B

SUMMARY TABLE OF FEES AND CHARGES OF VARIOUS MASTER TRUSTS

Fee Comparison Retail Superannuation Products

Product	Contributions	Account Fee per month	Management Fee per annum *	Investment Fee per annum *	Reference
Colonial Master Fund – Corporate Super	4.5%	$4.10	1.5%	0.25% - 1.5%	Colonial Master Fund Corporate Superannuation – Member Booklet, 10 May 1999, pp9-17
IOOF Master Fund – Entry Fee	4%	$6.35	1.1%	0.3% - 1%	IOOF Master Fund - Key Features Statement (KFS), 1 July 1999, pp 6-7
IOOF Master Fund – Nil Entry Fee	0%	$6.35	1.8% first 5 years then as per entry fee option	0.3% - 1%	IOOF Master Fund – KFS, 1 July 1999, pp 6-7
AMP Flexible Life Time Super – Entry Fee	4.5%	$5.88	1.45%	0.2% - 1%	AMP Flexible Lifetime Super KFS, 14 February 2000, pp4-5
AMP Flexible Life Time Super – Deferred Contribution Fee	0% (1.35% pa deducted each month for four years on each contribution)	$5.88	1.45%	0.2% - 1%	AMP Flexible Lifetime Super KFS, 14 February 2000, pp4-5
National All in One – Entry Fee Option	4% all lump sum contributions or 1.5% on regular contributions	-	1.6% (minimum $6.00 per month)	External manager fee of 0.4% - 0.9%applies if external manager used	National All In One Superannuation Fund – KFS & CIB, 14 December 1999, pp3-5
National All in One – Nil Entry Fee Option	0%	-	1.95%	External manager fee of 0.4% - 0.9%applies if external manager used	National All In One Superannuation Fund - KFS & CIB, 14 December 1999, pp3-5
Mercantile Mutual Pooled Superannuation	5%	$5.00	1.5% - 1.95%	-	Mercantile Mutual Pooled Superannuation – Adviser Product Summary, www.mercadviser.com.au, 8 June 2000
Zurich Superannuation Plan	5%	-	1.7%	0.25% – 0.95%	Zurich Superannuation Plan – KFS, 28 February 2000, pp2-4
BT Lifetime Super Employer Plan	5%	$4.50	1.85%	-	BT Lifetime Super Adviser Guide, February 2000

* These fees are charged on total assets of account, not just on earnings

ATTACHMENT C

DISCLOSURE MODEL

DISCLOSURE MODEL

NAME: ……………………………………………….

DATE OF BIRTH: ……………………… COMMENCING SALARY: $………

CONTRIBUTIONS: **Year one: $……………**

ACCOUNT BALANCE AT INCEPTION: $…………..

FEE STRUCTURE:

- Administration Fees
  - $ per week/month/year
  - % of contributions
- Trustee Fees
  - $ per week/month/year
  - % of account balance
- Fund Manager Fees
  - $ per week/month/year
  - % of account balance
- Other
  - $ per week/month/year
  - % of contributions
  - % of account balance

Years	Salary $	Gross Investment Return - %p.a.			
		6		8	
		No Fees -$	Xxx Fees -$	No Fees -$	Xxx Fees -$
5					
10					
(to 55)					
(to 60)					
(to 65)					

Note: fees expressed in $'s, contributions and salaries increase by x% p.a.

DISCLOSURE MODEL

NAME: JOHN S. BLOGGS

DATE OF BIRTH: 18/6/1964 COMMENCING SALARY: $35,000

CONTRIBUTIONS: Year one: $3,150

ACCOUNT BALANCE AT INCEPTION: $ -

FEE STRUCTURE: XXX = Master Trust

- Administration Fees
  - $1 per week/month/year
  - 5% of contributions
- Trustee Fees
  - $- per week/month/year
  - 1.0 % of account balance
- Fund Manager Fees
  - $ per week/month/year
  - 0.5% of account balance
- Other
  - $- per week/month/year
  - -% of contributions
  - -% of account balance

Years	Salary $	Gross Investment Return - %p.a.			
		6		8	
		No Fees -$	Xxx Fees -$	No Fees -$	Xxx Fees -$
5	39,600	16,451	14,620	17,268	15,337
10	44,800	41,085	35,088	45,389	38,674
(to 55)	56,000	116,940	92,661	142,694	112,129
(to 60)	66,000	185,339	140,611	239,943	179,657
(to 65)	71,400	281,466	204,192	387,656	275,939

Note: fees expressed in $'s, contributions and salaries increase by 3% p.a.

DISCLOSURE MODEL

NAME: JOHN S. BLOGGS

DATE OF BIRTH: 18/6/1964 COMMENCING SALARY: $35,000

CONTRIBUTIONS: Year one: $3,150

ACCOUNT BALANCE AT INCEPTION: $ - +

FEE STRUCTURE: XXX = Industry Super Fund

- Administration Fees
  - $1 per week/month/year
  - -% of contributions
- Trustee Fees
  - $- per week/month/year
  - % of account balance
- Fund Manager Fees
  - $ per week/month/year
  - 0.5% of account balance
- Other
  - $- per week/month/year
  - -% of contributions
  - -% of account balance

Years	Salary $	Gross Investment Return - %p.a.			
		6		8	
		No Fees -$	Xxx Fees -$	No Fees -$	Xxx Fees -$
5	39,600	16,451	15,885	17,268	16,671
10	44,800	41,085	39,147	45,389	43,215
(to 55)	56,000	116,940	108,629	142,694	132,188
(to 60)	66,000	185,339	169,626	239,943	218,652
(to 65)	71,400	281,466	253,670	387,656	347,209

<u>Note:</u> fees expressed in $'s, contributions and salaries increase by 3% p.a.