

Standardised Disclosure of Fees and Costs - the Way Forward

[Updated April 2007]

Earlier versions of this note were published in the August 2003 and May 2004 editions of *Actuary Australia*, the monthly magazine of the Institute of Actuaries of Australia. The purpose of this note is to update the original articles and to include a number of useful refinements suggested by various industry participants.

To help consumers compare different superannuation plans and products requires some standardisation in the way that fees, charges and costs are disclosed in Product Disclosure Statements (or PDS's). In fact, the same can be said of any product with an investment component, such as a managed fund or a life office or friendly society investment-linked policy or bond.

Just over eight years ago, Colin Grenfell wrote an article "KFS Disclosure - no easy matter" which was published by the Association of Superannuation Funds of Australia (ASFA) in the December 1998/January 1999 edition of SuperFunds. The article summarised the then public views on fee disclosure as expressed by the Liberal-National Coalition, the Labor Party, the Australian Securities and Investments Commission (ASIC), the Industry Funds Forum and others.

The article also noted that the Institute of Actuaries of Australia recommended that:

- (1) Investment performance should be reported net of tax and investment transaction costs and net of all investment costs.
- (2) Key Features Statements should include a brief description of all fees and charges.
- (3) In addition there should be some form of analysis of the impact of fees and charges which should focus on all non-investment fees and charges.
- (4) The impact of these fees and charges should be shown net of employer subsidies but should include any costs in excess of fees and charges.

The authors of this note believe that these four recommendations reflect sound principles that remain valid today.

The authors note that the Institute's principles include the need to show separately the effect of investment fees and costs and of non-investment (or broadly administration) fees and costs. The authors consider this split is essential for a sound comparison of funds. The split also facilitates member investment choices. It is noted that the Report commissioned by ASIC from Professor Ian Ramsay, released in September 2002, recommended that investment and administration fees should be separated.

The August 2003 and May 2004 articles explain the background and relevant events since 1998. A further article in August 2005 expands on recommendations (1) and (3) above.

What happens next?

We suggest that the way forward should include the following three level fee disclosure framework:

1. At a glance

This component of the framework would summarise the existence of various fees and costs using standardised terminology, order of contents and grouping. For example;

INVESTMENT		ADMINISTRATION	
Ongoing fees	<i>Yes</i>	Initial fees	<i>No</i>
Ongoing extra costs	<i>Yes</i>	Ongoing fees	<i>Yes</i>
Switching fees	<i>Yes</i>	Ongoing extra costs	<i>Yes</i>
Buy-sell spread	<i>Yes</i>	Benefit fees	<i>Yes</i>
		Exit fees or penalties	<i>No</i>

OTHER		
Any other fees or costs?		<i>No</i>
Are any dollar fees indexed		<i>Yes</i>
Might fee rates increase in next 5 years?		<i>No</i>
Are some tax deductions withheld?		<i>No</i>

2. Brief description

This component would be similar to the brief descriptions of fees and charges used in Member Booklets and some PDS's, but there would be a few important constraints. For example;

- Must include brief descriptions of how each of the above "**Yes**" responses is calculated and charged.
- Must start a new paragraph for each fee or cost.
- Must be in the same order as the first component and use the same grouping.
- Must use standard terminology similar in style and depth to the requirements of Corporations Amendment Regulations 2005 (No. 1) but, primarily as a consequence of the separation of fees and costs into "investment" and "administration" components, without the unnecessary and confusing terms "management costs" and "other management costs".

3. Impact of fees and costs

This third and final component would have two distinct parts, one for Investment fees and costs and one for Administration fees and costs. For example;

INVESTMENT

For each investment option, list:

- (a) the ongoing net of tax fees and extra costs as a single annual dollar amount per \$10,000 of average assets (eg. if fees were .44% net of tax and the only other investment costs were Consultant's fees of .09% net of tax, then list \$53 per annum for this option), and
- (b) the buy-sell spread (if any) and state whether this margin is paid to the fund manager or left in the fund for the benefit of other members.

ADMINISTRATION

A standardised expense deduction table (similar to that now required in the United Kingdom) for at least two levels of contributions. This is probably the most important part of the framework.

This part includes the following five columns for initial annual contributions of \$2,500 and \$5,000 respectively:

- | | |
|---|----------------------------|
| (1) At end of years | 2, 5, 10, 20 and 40 |
| (2) Total paid in to date | 3 or 4 significant figures |
| (3) Account balance without fees and costs deducted | 3 or 4 significant figures |
| (4) Effect of fees and costs to date | 2 or 3 significant figures |
| (5) Account balance with fees and costs deducted
[= (3) - (4)] | 3 or 4 significant figures |

Sample Product Disclosure Statements

Two sample Product Disclosure Statements, which reflect the principles that we consider should apply to fee and cost disclosure, have been prepared and can be supplied if required. One sample is for a hypothetical Retail superannuation fund and the other is for a hypothetical Industry plan. (They have not been updated to reflect legislative changes since 2004.)

The next page is an extract from the latter PDS to illustrate the third component of our recommended framework.

Colin Grenfell and Ray Stevens

[extract only]

Table 4: ZIS Annual INVESTMENT Fees and Costs Summary per \$10,000 account balance in each investment option

Ongoing (and Extra)	Option A: \$161 Option B: \$140 Option C: \$124
Buy-sell spread	Nil

Assumptions on which the following fee table is based

The table below uses the standard assumptions about account balance, contributions and investment returns that all funds must use to show the impact of their administration fees and costs. These assumptions are as follows:

- Account balance at start: nil.
- Initial Annual Employer contributions of \$2,500 or \$5,000 (before tax).
- Contributions payable mid-year (or say weekly) and increasing by 4.5% each year.
- Member contributions: nil.
- Net annual investment return of 7% (net of tax and net of investment fees and costs).
- Dollar fees increase by 3% each year.
- Results in “**today’s**” **dollars** (ie deflated using a salary increase assumption of 4.5% each year).
- No allowance for any tax payable on benefits.

Table 5: Effect of ZIS ADMINISTRATION Fees and Costs

If withdrawn	Total Paid in to date	Account Balance without fees and costs deducted	Effect of fees and costs to date *	Account Balance with fees and costs deducted *
Initial Annual Contribution \$2,500				
after 2 years	\$ 5,000	\$ 4,350	\$ 120	\$ 4,230
after 5 years	\$ 12,500	\$ 11,280	\$ 330	\$ 10,950
after 10 years	\$ 25,000	\$ 23,970	\$ 860	\$ 23,110
after 20 years	\$ 50,000	\$ 54,300	\$ 2,800	\$ 51,500
after 40 years	\$100,000	\$141,500	\$12,300	\$129,200
Initial Annual Contribution \$5,000				
after 2 years	\$ 10,000	\$ 8,700	\$ 130	\$ 8,570
after 5 years	\$ 25,000	\$ 22,560	\$ 420	\$ 22,140
after 10 years	\$ 50,000	\$ 47,940	\$ 1,260	\$ 46,680
after 20 years	\$100,000	\$108,600	\$ 4,600	\$104,000
after 40 years	\$200,000	\$283,000	\$22,500	\$260,500

* The fees and costs include all fees and costs, except investment fees and costs and insurance charges. They include the benefit payment fee. For ZIS there are no other surrender penalties or exit fees and ZIS does not pay any commissions.

The last line of Table 5 (for an annual contribution of \$5,000) shows that over a 40 year period the effect of the total deductions could amount to \$22,500 (in today’s dollars). Putting it another way, this would have the same effect as bringing investment returns down from 7% a year to 6.61% a year.