

# Consumer Understanding of Fees and Charges – Implications for the Industry

Ageing Agendas was engaged by the Association of Superannuation Funds of Australia (ASFA) to undertake consumer testing of two Product Disclosure Statements (PDS) comprising information about the Ongoing Management Charge (OMC) for two fictitious funds and their respective investment options.

A copy of the OMC information contained in one of the PDS documents is included in the appendix to this paper.

Copies of the PDS documents were sent to twenty-four consumers before the interview to allow them to read them as they would if they were choosing a fund. Participants were asked to read the documents and were told that they could refer to the documents during the interview. The participants were advised that the questions they would be asked would include some which would require them to consider the information contained in the OMC tables related to investment options.

Interview schedules developed by Ageing Agendas in conjunction with ASFA were used to test participants' understanding of terms used in the documents, their understanding of the information contained in them and their capacity to recall and find information. The interview schedule contained questions designed to test participants' capacities to compare the documents and their capacities to make informed choices.

## Research Findings

Overall, the performance of research participants was poor. This was the case with people who were undertaking or had completed tertiary studies and those without tertiary qualifications.

Only 10% of this sample was able to answer 90% of the questions correctly.

At one level, the poor performance of the sample is in part linked to the introduction of the OMC. It is the view of the research team that the OMC material itself added to the confusion of participants in the research in that it effectively 'muddied the waters' when it came to the focus of the research - fees and charges and the ability to compare funds and investment options. As one participant stated:

*The start of them and the stuff about contributions was easy to understand – it was just the OMC I had no idea about.*

# Participant Performance

The OMC was a source of confusion for most participants. 80% of participants saw it as an additional fee.

Some participants did not take much notice of the individual fees after they had discovered the OMC.

*I didn't worry too much about individual charges because I took it that the overall OMC includes them all. I checked it out and it does.*

One participant volunteered:

*... I get the impression that it's a way to compare but I couldn't.*

Most research participants commented that they thought the OMC section of the booklets was less useful than the other sections.

*I found the OMC very complex. I read it a number of times and I still wasn't extremely clear.*

*It would be a good idea to put the OMC and then list under it what that consists of.*

Most research participants saw the OMC as an additional charge to the fees and charges laid out in the booklets. As one participant commented:

*Seems like another excuse to charge you more fees.*

The research tested the option to provide the OMC for investment options as a separate document or in a separate part of the booklets. This proved to be a major contributor to poor performance. The majority of participants could not locate the OMC Options table when asked to do so. The research experience revealed that consumers clearly need to have comparison material presented in the same manner and in the same location in documents if they are to develop and exercise informed choice.

The manner in which the OMC was explained also left a lot to be desired. While it may make sense to those familiar with superannuation, it meant little to consumers. The tendency to use a minimum of words to explain a complex concept did not meet the needs of most of these consumers.

Even those participants who performed particularly well in the testing said that the OMC was poorly expressed. One said,

*.. it shouldn't be this hard.*

Other participants said of the OMC:

*It would be more useful if I knew exactly what it was and what it is measuring.*

*It depends on your knowledge of it. To me it's just a whole lot of figures. I'd probably get some advice before picking a fund. I'd ring the funds and get them to explain things or you could go to your parents. (This person was one of the few who had sought advice in the past)*

## **Improvements**

Participants who had difficulties with the OMC section in particular, argued for less use of percentages and a greater use of examples to illustrate the impact in dollar terms. One participant suggested that the PDS provide an illustration of the impact of fees and charges on an investment balance over time.

Another suggested that he would be greatly assisted with a one-page summary of all the key issues.

One participant also argued that the tables should be bigger and that the use of colour might provide greater assistance in understanding.

The layout of the OMC section of the booklets is poor and can be more effectively expressed. The very title 'Ongoing Management Charge' was a source of confusion for some of the participants. Also the use of jargon needs to be minimised and the tendency to attempt to explain complex concepts with an economy of words needs to be resisted.

The level of understanding of fees such as Trustee Management, Monthly Expense Recovery and Additional Expenses was very low and the way in which they were presented tended to engender participant distrust. They argued that the absence of detail about these fees raised suspicion that these were simply additional ways to charge members more for their services.

## **Round Two**

ASFA developed three alternative models for comparing fees charged by different funds. These models were presented in the context of the two PDS documents to a sample of consumers who were interviewed to determine the level of understanding of the material and their capacity to compare funds and investment options.

One of the sets was comprised of three tables which presented consumers with fees and charges information related to investment returns, information related to fees and charges deducted from contributions or the account balance and the total effect of fees. In each case the tables indicated the different impact of fees according to each investment option.

**Table 4A: Effect of AIS fees and charges deducted from investment returns**

	<b>Active Option</b>	<b>Balanced Option</b>	<b>Conservative Option</b>
<b>If withdrawn</b>	cost of fees *	cost of fees*	cost of fees *
<b>after 2 years</b>	\$ 200	\$ 170	\$ 140
<b>after 10 years</b>	\$ 2,930	\$ 2,180	\$ 1,640
<b>after 30 years</b>	\$ 44,230	\$ 24,820	\$ 14,220

*All amounts have been rounded to the nearest \$10. Figures are in today's dollar values.*

**Table 4B: Effect of AIS fees and charges deducted from contributions or account balance.**

	<b>Active Option</b>	<b>Balanced Option</b>	<b>Conservative Option</b>
<b>If withdrawn</b>	cost of fees *	cost of fees*	cost of fees *
<b>after 2 years</b>	\$ 120	\$ 120	\$ 120
<b>after 10 years</b>	\$ 630	\$ 580	\$ 540
<b>after 30 years</b>	\$ 3,110	\$ 2,310	\$ 1,740

*All amounts have been rounded to the nearest \$10. Figures are in today's dollar values.*

**Table 4C: Total effect of AIS fees and charges**

	<b>Active Option</b>	<b>Balanced Option</b>	<b>Conservative Option</b>
<b>If withdrawn</b>	cost of fees *	cost of fees*	cost of fees *
<b>after 2 years</b>	\$ 320	\$ 290	\$ 260
<b>after 10 years</b>	\$ 3,560	\$ 2,760	\$ 2,180
<b>after 30 years</b>	\$47,340	\$ 27,130	\$ 15,960

*All amounts have been rounded to the nearest \$10. Figures are in today's dollar values.*

The second set presented a single table which indicated the total cost fees and charges associated with the investment options.

**Table 4: Effect of total AIS fees and charges.**

	<b>Conservative Option</b>	<b>Balanced Option</b>	<b>Active Option</b>
<b>If withdrawn</b>	<b>Total cost of fees *</b>	<b>Total cost of fees*</b>	<b>Total cost of fees*</b>
<b>after 2 years</b>	\$ 260	\$ 290	\$ 320
<b>After 10 years</b>	\$ 2,180	\$ 2,760	\$ 3,560
<b>After 30 years</b>	\$15,960	\$27,130	\$47,340

*All amounts have been rounded to the nearest \$10. Figures are in today's dollar values.*

The third set contained a table that presented the total cost of fees over time and the projected balance, based upon a standard set of assumptions.

**Table 4: Effect of total AIS fees and charges.**

	<b>Active Option</b>		<b>Balanced Option</b>		<b>Conservative Option</b>	
<b>If withdrawn</b>	<b>Account balance without fees</b>	<b>Total cost of fees *</b>	<b>Account balance without fees</b>	<b>Total cost of fees *</b>	<b>Account balance without fees</b>	<b>Total cost of fees *</b>
<b>after 2 years</b>	\$ 9,860	\$ 320	\$ 9,560	\$ 290	\$ 9,280	\$ 260
<b>After 10 years</b>	\$ 36,110	\$ 3,560	\$ 31,890	\$ 2,760	\$ 28,210	\$ 2,180
<b>After 30 years</b>	\$191,580	\$47,340	\$130,630	\$27,130	\$ 91,000	\$15,960

*All amounts have been rounded to the nearest \$10. Figures are in today's dollar values.*

Again 24 consumers were recruited for the testing process. Copies of the PDS documents, each containing three variations on fee disclose were sent to consumers before the interview to allow them to read them as they would if they were choosing a fund.

The participants were advised that the questions they would be asked would include some which would require them to indicate their preferred option for fee disclosure and that they would be asked why that option appealed to them.

## Outcomes

The performance of research participants was strong in a number of areas where information on fees and charges was relatively straightforward. These results were significantly better than for previous testing of the OMC.

Yet only 26% of this sample (6 participants) was able to answer 90% of the questions correctly. 56.6% (13 participants) were able to answer 80% of the questions correctly. The researchers are confident that with improvements suggested by the research outcomes, the effectiveness of the guides will improve significantly. In the first round of consumer testing (in which the OMC was tested), the performance of consumers was significantly poorer with only 10% of the sample able to answer 90% of the questions correctly.

In this round of testing Research participants understood and valued the comparison table options. The majority (12 AIS and 15 MPS) of participants expressed strong preference for the options that presented total fees and total projected balance. This illustrated that consumers value the provision of a projected balance in conjunction with the provision of the combined fees and charges figures. The reasons they offered included:

*Because it included the account balance.*

*It gave you the bottom line – the value of the account and the fee that you'd pay. It was very clear.*

*It's simple and has the comparison between fees and balance.*

*Simpler than 1 and it gave you the total without fees and the fees. (Two participants)*

One concern we had was whether people would regard the projected account balance as a “promise”. Our testing indicates that most of the participants who referred to the importance of the ‘balance’ understood that it was based on a defined set of assumptions. We have recommended some layout changes to reinforce this and the underlying assumptions.

It also indicated that they generally do not favour additional information on the breakdown of fees – they simply want to know the total fees and charges they are likely to face. Two participants said they liked the third option:

*Because it gives the total cost of fees. The others give more information and I just want to know the total) It was simple and I liked having the account balance.*

## Recommendations

The outcomes of the research indicate that there are a number of ways in which consumer understanding of superannuation and their capacity to choose between funds can be enhanced.

The most significant suggests that the superannuation industry adopt a model for disclosure and comparison that presents the total cost of fees over time and the projected balance, based upon a standard set of assumptions. This was clearly the most effective means for consumers to gain an understanding of the impact of fees and charges as a basis for comparison with similar information for other funds.

The research also revealed the importance of a standard approach to disclosure which presents the same table headings and uses the same terms. Consumer performance in this round of testing indicated that consumers who are uncertain about superannuation terms are easily misled where headings and terms that deal with the same issues differ from each other.

This points to the value in checking consumer understanding of superannuation publications before their release to ensure that the assumptions of the industry about information, terms and concepts are understood by consumers.

The difficulty consumers have in identifying and understanding superannuation suggests that funds consider ways of further promoting their telephone support services. It was clear that many of the consumers who participated in the research would not make a decision on the grounds of their reading a PDS alone. The industry might consider using reminders, such as call out balloons within their publications to draw consumer attention to the service particularly in those parts of publications where consumers are likely to experience difficulty understanding issues.

Finally, to enhance the level of consumer understanding we have recommended that ASFA develop a checklist for comparison of key decision-making issues. This would require consumers to look for figures or features in the PDS and record them on the checklist. This would serve to encourage consumers to pay attention to this information and engage them in an interactive process of seeking and recording relevant information. The checklist would then provide a basis for comparison between funds.

Ageing Agendas has recommended that such a tool be tested along with a number of other formatting changes to the draft PDS documents. We also feel that the preference for the comparison table and the assumptions which underpin the table should be the subject of further testing.

# 7 Comparing costs between funds

## Ongoing Management Charge (OMC)

The ongoing management charges paid and charged by a superannuation fund over a year can be expressed as a percentage of the fund's assets.

OMC for the MPSuper plan as a whole

In the last two years, the ongoing management charges of this plan, as a percentage of the plan's total assets were as follows:

**Table 3 OMC for MPSuper Plan as a whole**

	2001-02	2002-03
Actual OMC	2.40%	2.35%
Actual OMC relating to the management of investments	1.60%	1.55%
Actual OMC not relating to the management of investments	0.80%	0.80%

## OMC for the individual investment options

In the last two years, the ongoing management charges of the individual investment options, as a percentage of the assets invested in each investment option, are set out in Table 4.

**Table 4 OMC for the individual investment options**

	2001-02	2002-03
<b>Growth Option</b>		
Actual OMC	2.50 %	2.45 %
OMC related to management of investments	1.65 %	1.60 %
OMC not related to management of investments	0.85 %	0.85 %
<b>Balanced Option</b>		
Actual OMC	2.45%	2.40 %
Related to the management of investments	1.60%	1.55 %
Not related to the management of investments	0.85%	0.85 %
<b>Conservative Option</b>		
Actual OMC	2.12%	2.10 %
Related to the management of investments	1.12%	1.10 %
Not related to the management of investments	1.00%	1.00 %
<b>Cash Option</b>		
Actual OMC	1.80%	1.77 %
Related to the management of investments	0.80%	0.77 %
Not related to the management of investments	1.00%	1.00 %

### Dollar examples of OMC

The approximate effect of the ongoing management charges (based on the charges for the year to 2002-03) on your benefits can be shown by multiplying this percentage by the amount in your account.

The following example shows the approximate amount of ongoing management charges for an account balance of \$10,000 in relation to the overall fund. The actual effect of ongoing management charges will depend on the fund's charging arrangements and individual circumstances. In particular, the amount in your account – and your chosen investment strategy – may have a significant effect on the amount of charges borne.

#### Example

If your account balance were \$10,000, based on the OMC for the fund as a whole of 2.2%, the ongoing management cost for 2002/3 would have been \$235. You can use this information to compare the effect of the OMC of this fund with that of other similar funds.

The costs included in the overall OMC of the fund or an investment option are all investment management fees and administration charges, except for switching costs.

The OMC relating to investment costs covers the investment fees paid by the fund to the various investment managers.

The OMC not relating to investment management includes the administration fee (but not the benefit payment or switching fees).

The ongoing management charge for a superannuation fund is required by law to be calculated and disclosed. Its purpose is to give a broad indication of the level of costs incurred by a particular fund as a percentage of the value of assets.

Costs include all fees, charges and expenses except for switching fees and benefit payment fees. The level of costs incurred by an individual product holder will depend on individual circumstances and as a percentage of value of the fund assets of the individual may be more or less than the ongoing management charge.

For example, the OMC you would have incurred on a \$10,000 account in 2002/3 for the individual investment options in XYZ are as follows:

**Table 5 Examples of OMC for investment options**

Growth option	\$245
Balanced option	\$240
Conservative option	\$210
Cash option	\$177

The ongoing management charge should not be taken to be representative of the actual fee and charges that will be borne by an individual.

**You should read section 5 Fees and Charges for details of all fees. Note that past charges should not be taken to be an indication of future charges.**