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COMMENTARY

High fees fleece CPF members of investment returns

Sales commissions, high management fees eat into CPF savings

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ONE of the recommendations from the CPF Advisory Panel in August 2016 was the dire need to review the CPF Investment Scheme (CPFIS). The scheme currently operates under a retail model.

As a consequence, CPF members do not enjoy the economies of scale afforded by institutional retirement plans like those in the US, the UK or Netherlands, where the "all-in" fees for both private- and public-sector plans are kept to a minimum, and financial advisers are held to a high fiduciary standard.

For example, according to the US Investment Company Institute's June 2017 study, the average expense ratio that 401(k) retirement plan members in the US paid for investing in equity funds in 2000 was 0.77 per cent. By 2016, the average expense ratio had fallen to 0.48 per cent.

In comparison, US retail investors paid an average expense ratio of 1.28 per cent for identical equity funds offered in non-retirement accounts.

The fees that CPFIS investors pay, on the other hand, can be as high as 3 per cent in sales charges for unit trusts and Investment-Linked Insurance Policies purchased through financial advisors, and up to 1.75 per cent in total expense ratios for actively-managed funds.

Incidentally, US Federal law requires those responsible for managing private-sector retirement plans, such as 401(k) plans, to be held to a much higher standard than brokers, and to carry out their fiduciary responsibilities prudently and in the best interest of the plan's members.

Among their other duties, fiduciaries have a responsibility to ensure that the services provided to retirement schemes are necessary, and the costs reasonable.

Similarly, the UK in 2013 banned sales commissions to reduce the potential for bias in financial advisers' product recommendations.

The Netherlands also removed brokerage commissions, and shifted from product-driven sales of financial products towards client-centric advice.

After all, every one of these fiduciaries would acknowledge that high fund expenses and sales-related costs significantly erode investment returns.

Although the CPF Board has over the years worked to progressively reduce the recurrent annual all-in fees within the CPFIS, the fees are still relatively high.

Nevertheless, presumably as a result of the recommendation of the CPF Advisory Panel, it was announced in March 2017 that the Ministry of Manpower and the CPF Board would be reviewing a few aspects of the CPFIS.

The review would include the introduction of a self- assessment tool with respect to investor suitability, lowering the cap on sales charges, and reviewing the types of funds offered within CPFIS to ensure that they are appropriate for growing one's retirement savings.

Additionally, the same authorities would hopefully also consider introducing mechanisms and penalties to prevent the "churning" of retirement funds, which also erode investment returns.

Many of the aforementioned countries and retirement plans have already instituted such "churning" safeguards.

Of the above, the CPF Board should tackle the issue of sales charges urgently.

While many have argued that CPFIS is more suitable for the knowledgeable or sophisticated investor who in general does not need to rely on advisors to pick and choose financial products, why should anyone pay a sales charge when a member can already purchase them with CPF monies through online platforms such as FundSupermart, Navigator and Poems without such charges?

Brokerage-type commissions incentivise financial advisors to push sales with little or no regard for the suitability of products for their customers.

This was true in the Netherlands, the UK and the US until their federal laws tightened things up for all fiduciaries, including financial advisers and retirement plan sponsors. This is almost certainly true in Singapore as well.

Sales commissions and high management fees eat dramatically into CPF members' retirement savings. Members may not even be aware how much fees they are paying.

For example, for a S$10,000 purchase of a unit trust, the financial advisor gets S$300 right off the bat for the "advice" and selling he does within the CPFIS. As a consequence, only S$9,700 goes into the actual investment.

Additionally, someone who invests S$1,000 a year – let's assume that his returns are about 6 per cent a year – a 1 per cent annual fee will reduce his investment by about 20 per cent at the end of 30 years. This implies that one-fifth of his returns will be foregone due to fees.

I have three recommendations.

First, both financially-sophisticated and less financially-savvy CPF members should earn the risk- and fee-free CPF interest rates as much as possible.

Second, CPF members should avoid paying commissions to lower the cost of investing in the CPFIS, and perhaps wait for the new Lifetime Retirement Investment Scheme (LRIS) that would not only help "institutionalise" the all-in cost of investing, but also increase the available retirement products' inherent sophistication to the level available in the US, the UK and the Netherlands.

Third, that the CPF Board kindly hurry up with the reduction – or removal – of all sales charges within the CPFIS, and then introduce the LRIS as the CPF Advisory Panel recommended in August 2016.

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