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By email: superannuation@treasury.gov.au

Attention Darren Kennedy

This response has been prepared in response to a call for submissions from the Department of Treasury in regards to the *Protecting Your Super Package* announced by the Government at the 2018-19 Budget.

The *Protecting Your Super Package* has been designed to reduce the insurance premiums and fees charged to young members, inactive members and members with small superannuation balances. The package is also designed to reduce the number of people with unnecessary multiple accounts by increasing the extent to which small inactive accounts are transferred to the Australian Taxation Office (ATO), which will seek to transfer these balances into the members' active accounts.

Whilst we support the objectives of the package, we have identified several issues that we believe the Government could consider addressing during the implementation process. We have proposed a number of possible solutions to address the issues with this package.

Protecting Your Super Package

As outlined in the 2018-19 Budget, the Government's *Protecting Your Super Package* has the following three major elements:

- A cap on administration and investment fees charged on superannuation accounts with balances of \$6,000 or less at three percent of the account balance, in addition to banning superannuation funds from charging exit fees for any account.
- Changes to strengthen the ATO-led consolidation regime by requiring the transfer of all inactive accounts where the balances are below \$6,000 to the ATO. The ATO will be given powers to reunite ATO-held accounts with the member's account where possible.
- A requirement on superannuation funds to only offer insurance on an opt in basis in relation to accounts:
 - that have balances below \$6,000
 - of new members who are under 25 years old
 - that have not received a contribution for 13 months or longer.

We believe there may be several implementation issues with these proposals. Our view on the proposals, and suggested changes to these proposals are outlined below.

Cap on administration and investment fees and cessation of exit fees

Budget estimates suggest that there are approximately 10 million accounts with a balance of less than \$6,000. Many of these accounts are held in funds who have historically serviced younger Australians before finding permanent employment. This will be particularly impactful where funds have charged fixed dollar administration costs and so younger members (with lower balances) have paid more proportionately than other members. These funds may be forced to re-evaluate their fee proposal due to falling revenue.

The 3% cap on administration and investment fees will be implemented as a 1.5% cap on administration and investment fees on accounts with balances below \$6,000 for the six-month period immediately following the date on which the balance is calculated. We believe this design will prove problematic to administer as funds will find it difficult to monitor fees over these shorter intervals. Moving to an annual 3% cap, and then still applying the cap to those who exit throughout the financial year would be an approach that would be easier for funds to administer.

Transfer of inactive accounts to the ATO

Indicative impact on the superannuation market

As of 30 June 2017, \$18 billion of superannuation assets is deemed lost or inactive (under the current definition), \$4 billion of which is with the ATO. Government estimates suggest that the proposed change in thresholds for transfer to the ATO, coupled with proactively returning funds, will result in around \$6 billion in assets being returned to the active accounts of around three million members in 2019-20.

While not a large proportion of system assets in the context of a \$2.5 trillion superannuation system¹ the impact of this change will be felt by many funds. In some cases, this reduction of accounts, coupled with the fees changes noted above may expedite mergers for some small funds who will struggle to retain scale. Analysis of our *Super Insights* database shows that approximately 10% to 25% of a typical superannuation fund's member accounts could be transferred to the ATO under the revised definition of inactivity.

Issues with the 13 month definition of inactivity

The amended definition of inactivity may prove problematic. A period of 13 months may be insufficient to define an account as inactive, as:

- Superannuation Guarantee (SG) payments can be made quarterly so people going on parental leave for 12 months could have a period of 15 months between SG payments.
- Some people will be on parental leave for longer than 12 months, or may have a delay in finding a suitable new role after a planned period out of the Australian workforce to work overseas, study, raise children or provide care to relatives.

This could result in members losing accounts which they would prefer to keep for investment and/or insurance purposes, and at worst could lead to bereaved families suffering severe financial hardship due to loss of this insurance cover.

We recommend that members be able to specify that their accounts are not automatically transferred to the ATO in the event where no contributions are made for the defined inactive period. Members should be able to specify the length of time they will be inactive before they take their break. If this is not provided insurance may inadvertently be lost and be difficult to return.

¹ APRA Annual Superannuation Bulletin.

Further, consideration could also be given to excluding members who have actively interacted with the fund, for example those who have made changes to their investment strategy during the period of contribution inactivity.

Opt-in arrangements for insurance in superannuation

Inconsistency in policy descriptions

There appears to be an inconsistency between the policy description included in the Budget papers and the policy description included in the Explanatory Memorandum that accompanies the legislation. The measure description in Budget Paper 2 seems to suggest that all people under 25 holding group insurance policies in their superannuation (including those currently holding insurance) will be required to opt-in. The Explanatory Memorandum suggests that only new members under 25 (from July 2019) will be required to opt-in. This submission has been prepared on the basis that the Explanatory Memorandum is the correct description of the policy.

Protecting new members

The proposed policy removes insurance costs for many members who may have a lesser need for insurance. However, insurance has the greatest relevance for events that occur very rarely but cause severe impact. A lack of insurance in the event of death or disablement can have a material impact on individuals and their dependants.

Given a fund will not necessarily know a new entrant's circumstances, particularly for default members, the Government could consider specific short-term insurance arrangements for new members joining a fund. For example, insurance could be provided on an opt-out basis for the first 90 days of membership, after which time a person under 25 or who still has assets under the \$6,000 threshold would need to opt in to retain cover. This would also provide protection to members for whom an event happens whilst in the process of consolidating their superannuation and related insurance cover.

While the impact on individuals is difficult to quantify due to the vast range of individual circumstances, it is expected that vulnerable members with limited personal assets will be at greatest risk due to the changes. These will include some younger members who have dependants who will potentially be unable to obtain cover. Anecdotally, the major group life insurers believe that about 10% of those members dying under age 25 leave dependants. However, this can be as much as 20% in rural and regional areas.

Thus, once implemented it will be crucial that funds work to educate these vulnerable members so that they opt-in where appropriate. Alternately, funds could deduct a very small premium from members under 25 and only pay benefits to those with dependants.

High risk occupations

Superannuation funds may be the only option to obtain insurance cover for individuals working in a range of high risk occupations. We believe this is a particularly valuable service to these members. By offering opt-out cover to large numbers of members in these occupations, some funds have been able to negotiate the provision of cover to these members. For some occupations it could be difficult to obtain automatic cover outside group insurance through the superannuation environment. Members in these occupations may be unable to replace their cover if it was reduced or removed.

We have investigated the availability of cover in the retail market for several high risk occupations in the building industry. For this analysis, we have used the ten insurers included in the Rice Warner *Retail Risk Comparator* to determine the extent to which access to cover provided by superannuation funds may not be widely available outside the superannuation environment.

Table 1 shows the retail insurance availability across these occupations.

Table 1. Retail insurance availability for high risk building and construction occupations

Occupation	Number of retail insurers offering cover	Percentage of available insurers in survey group
Boilermaker	5	50
Bricklayer	1	10
Carpenter	8	80
Concreter	-	0
Dogman	-	0
Electrician	7	70
Fitter and turner	8	80
Labourer	-	0
Painter	3	30
Plasterer	2	20
Plumber	8	80
Rigger	-	0
Scaffolder	-	0
Welder	5	50

Of the fourteen occupations analysed, five – concreter, dogman, labourer, rigger and scaffolder – were not covered by any of the ten insurers in Rice Warner’s retail comparator. Painter had just three insurers, plasterers had only two available insurers and bricklayers had only one option.

We consider this to be a major issue for any employee working in these fields and it is one of the key reasons why group insurance through superannuation can have significant value.

Employer-financed insurance premiums

One of the key reasons for the proposed removal of opt out cover for members is to prevent the erosion of superannuation balances. For a portion of fund members, their employer pays additional superannuation contributions which meet or exceed the cost of insurance premiums. Some employers (including Rice Warner) provide life insurance through a superannuation policy unrelated to the member’s own fund. Where the employer pays additional contributions that cover insurance premiums, the provision of opt out insurance will not erode superannuation balances and therefore there is no need to remove opt out insurance for these members.

Many of these arrangements would have been negotiated in employee bargaining arrangements and would therefore be difficult to amend in the short term. Given the Insurance in Superannuation Code of Practice recommends that premiums for insurance held in superannuation should not exceed 1% of ordinary time earnings, the Government could exempt members from the opt-in arrangements where their employer contributes the insurance premium amount on top of SG or makes employer contributions of at least 1% greater than the legislated SG rate.

Potential impact on insurance premiums

From our consultations with market participants, we believe this policy change will likely result in an average increase in insurance premiums of around 5% to 10%. Whilst this impact may seem relatively modest in aggregate, the impact will not be uniform across funds.

The cost for a particular fund will vary dramatically depending on the:

- extent of any cross-subsidisation of existing premium rates across the membership
- proportion of insured members who are currently inactive
- proportion of insured members with balances under \$6,000
- proportion of insured membership under age 25
- the approach put in place to deal with ‘opt-in.’

For most individuals who do not make a claim over their working life, removal of default life insurance will result in improved retirement outcomes. This stems from the reduced premium deductions from their superannuation accounts. However, as Table 2 demonstrates, this benefit for an average member is minor, even where the proposed changes have no impact on pricing. Where premium increases of 15% are taken into account, the average retirement balances are only expected to improve by 0.27%. The individual modelled here has a premium reduction of around \$200 per year for the first seven years of their working life. Relative to the contributions over their life, the reduction in premiums is small and so the impact on their balance at retirement is not significant.

Table 2. Impact of Budgetary changes on individual’s retirement balance

Scenario	Balance at retirement (today’s dollars)	Percentage improvement from current
Current arrangements	528,300	-
Premiums start from age 25, premiums increased by 15%	529,700	0.27
Premiums start at age 25, no changes to premium rates	532,300	0.76

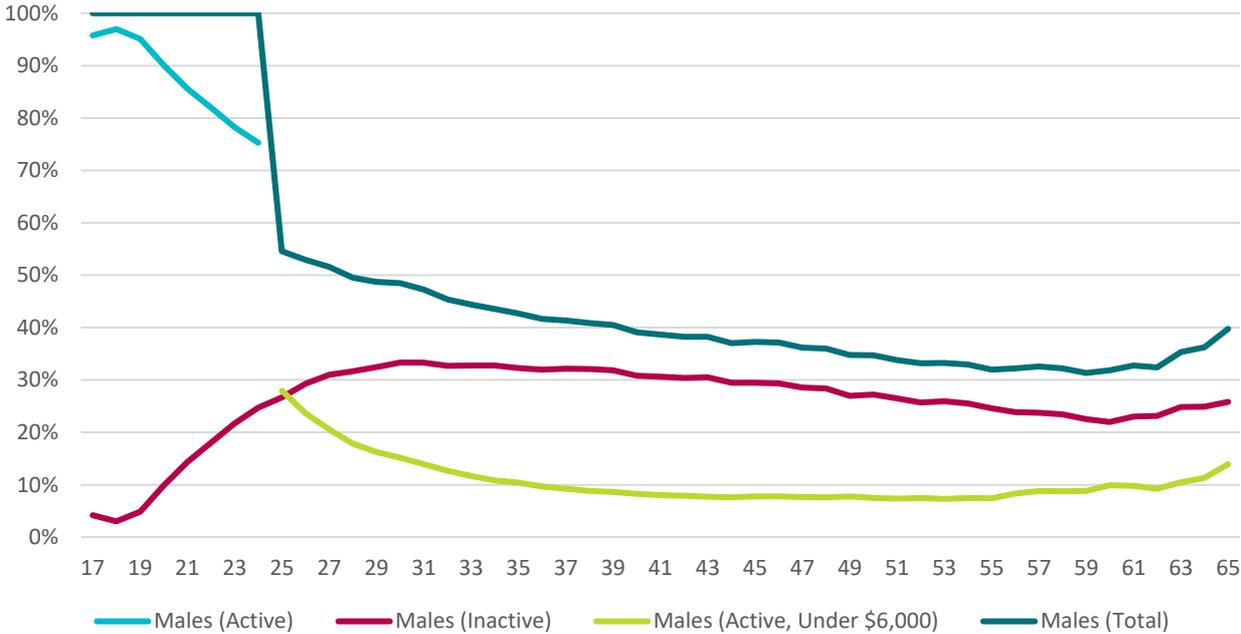
Administrative issues for new accounts

Analysis of our *Super Insight’s* database shows that around 40%-50% of the total sum insured would be lost under the full suite of changes to insurance opt-in arrangements. Graph 1 and Graph 2 show the distribution of insurance that would be lost by age and gender from the database.

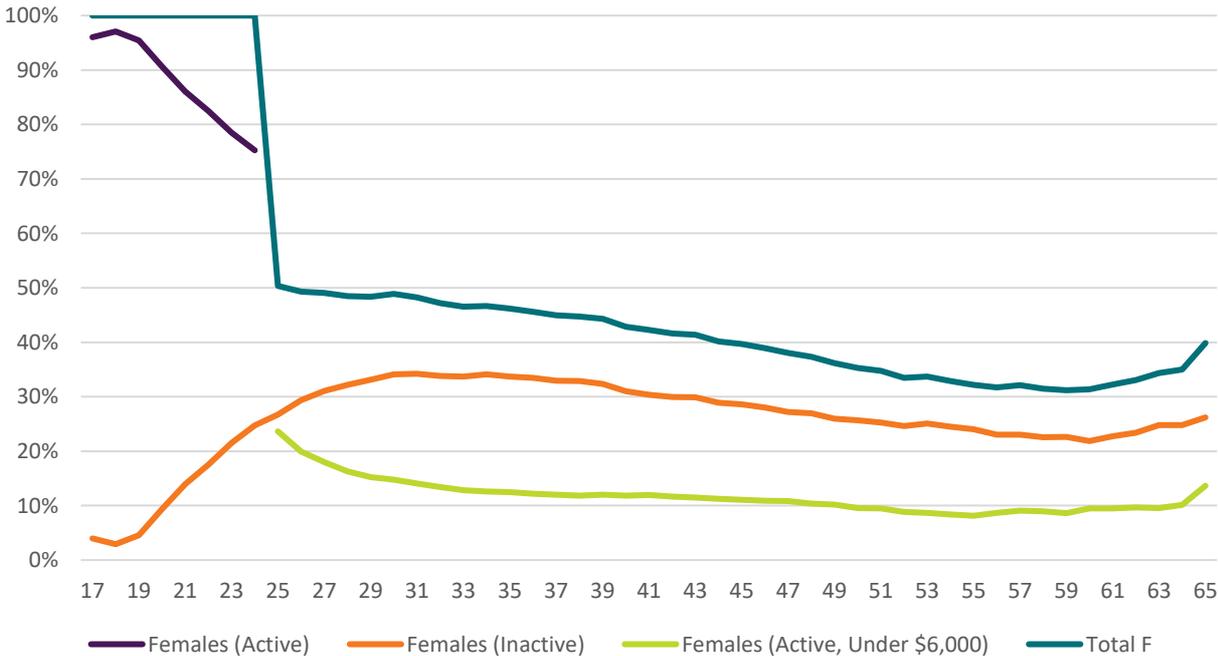
For illustrative purposes we have assumed that all those under 25 would in due course lose cover (i.e. not just new account members, as is initially the case with the proposed policy). This is appropriate for considering the longer term impact, as ultimately no members under age 25 will have opt out cover.

Overall these graphs show that for members over age 25, the proportion of the insurance lost will be primarily driven by the revised definition of inactivity, rather than the balance limit of \$6,000. The results are not significantly different for men and women. The graphs do not allow for auto consolidations.

Graph 1. Proportion of members impacted by respective changes (cover-weighted), males by age



Graph 2. Proportion of members impacted by respective changes (cover-weighted), females by age



Opt in only cover for active members with balances under \$6,000

The removal of opt-out cover for members with balances under \$6,000 is problematic in several ways and will prove challenging to administer. For example, every new member of a fund will be uninsured until their balance reaches \$6,000 via regular contributions or transfers from previous fund, leaving some individuals uninsured for a period of time. Further, it may prove difficult to determine the exact point at which cover turns on and off, and it could therefore be hard to determine 'at work status'. 'At work status' at date of cover commencement is required at the time of claim to determine whether a member is eligible to claim. There are therefore likely to be issues at claim time to determine whether some claimants were covered at the date of death or disability and possibly which insurer was at risk. This will inevitably be a source of fund and insurer complaints. It is expected that some members will find it difficult to understand whether they have cover at a point in time and for funds to put in place the necessary systems to identify the trigger that cover should be switched on. The \$6,000 minimum balance is likely to mean that some migrants will not be covered, particularly as many of them would have little understanding of the Australian superannuation and insurance systems. Some migrants may also have difficulties where English is their second language and this may mean they are less likely to opt-in.

Because the \$6,000 could be manipulated by individuals, the insurer may see a greater risk and introduce terms to minimise anti-selection such as pre-existing condition exclusions.

To ameliorate these issues, we believe it would be reasonable for the \$6,000 limit to be removed on the grounds of simplicity, and to reduce the consequent increase to a fund's administrative costs (which would be spread across all fund members).

APRA role to grant exemptions

In light of some of the issues mentioned, we believe that some funds have special circumstances which warrant exemption from the rules, e.g. additional employer contributions or high-risk occupations. It will be difficult to legislate for every circumstance (including those noted above). We therefore recommend that APRA be given powers to exempt some funds and employers from certain requirements (or modify them) where appropriate. This could be done by requiring the fund or employer to produce an actuarial certificate to back the variation.

Timing of implementation of insurance changes

The insurance changes are due to take place from 1 July 2019, requiring that members be given notice by 1 May 2019 so that they can choose to opt in to retain their cover before the commencement date.

Given the significance of these changes, funds will likely need to renegotiate the terms of their contracts with insurers. This is a process which requires significant time and resources from both the fund and the insurer. This exercise would generally commence at least one year before implementation and for most funds occurs every three years. This means that insurers will require considerably more resources to be able to deal with pricing requirements. Funds that have recently renegotiated premium rates with premium guarantees of three years will be forced to pay to go through the exercise again and the outcome for members may be a large premium increase. Where the incumbent insurer increases premiums to an extent that the trustee does not feel is justified, funds will have insufficient time to tender for insurance services.

Fund administrators will similarly be under pressure to develop systems to cater for the changes. There is a risk that rushing to implement will mean that errors occur and could result in member complaints and/or members losing cover inadvertently.

Submission - Protecting Your Super Package
Department of Treasury

We therefore recommend that the proposed changes be deferred until the later of the fund's next premium rate guarantee expiry and 1 July 2020.

We hope this information will prove useful as the proposed policy changes are implemented.

Yours sincerely

A handwritten signature in black ink that reads "Michael J. Rice". The signature is written in a cursive style with a large, prominent 'J'.

Michael Rice
CEO & Authorised Representative
Rice Warner Pty Ltd AFSL 239 191