asfa
the voice of super

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Manager, Regulatory Framework Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email to: superannuation@treasury.gov.au

Dear Sir/Madam

Protecting Your Super package

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the exposure draft *Treasury Laws Amendment (Protecting Superannuation) - Bill 2018* (Draft Bill) and the related draft Explanatory Materials.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.6 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 14.8 million Australians with superannuation.

ASFA uses an evidence-based approach to advocate for legislative changes that will ensure the best possible retirement outcomes for Australians and ensure our superannuation system remains the envy of the world.

When analysing proposed policy settings, ASFA draws on its extensive research to assess the proposal according to its impact on sustainability, adequacy and equity of the system, as well as to identify the consequences (both intended and unintended) for superannuation fund members.

The Association of Superannuation Funds of Australia | **ABN 29 002 786 290**
Level 11, 77 Castlereagh Street, Sydney NSW 2000
t 02 9264 9300 f 1300 926 484
www.superannuation.asn.au

Australia's superannuation system underwrites the health of our economy, fosters innovation in investment products and reduces the financial burden of the Age Pension on future generations. For these reasons, it is so important to get the policy settings right.

ASFA is strongly committed to improving the experience that Australians have with their superannuation, especially in the early stages of employment when members are often young, have lower balances and are on lower incomes. We support policy initiatives that reduce the proliferation of unnecessary accounts and insurance.

We have worked with the ATO for the development of super matching, account consolidation and online superannuation choice services.

Additionally, ASFA is one of the owners of the superannuation industry's Code of Practice that specifically addresses several of the unintended outcomes that have arisen with the current insurance in superannuation policy settings. This code has already had an impact on the re-design of more affordable and appropriate insurance offerings and given time we are confident it will deliver on its objectives.

A. General Comments

Insurance changes

While ASFA supports ensuring retirement balances are not unnecessarily eroded by insurance (hence our commitment to the Insurance in Superannuation Code of Practice), we consider that this objective could be met in a more targeted fashion through modifying the Government's protecting your super package as follows:

- Automatic insurance being provided for individuals over 21 (rather than 25) as this is the age by when a significant number of young people have commenced full-time employment and to minimise unintended consequences related to not having any insurance in place.
- When someone turns 25 (or as we propose 21) automatic insurance can be provided immediately upon joining a fund (without an account balance of $6,000 having to accrue) if contributions are being made. This would avoid working Australians having to wait a potentially long period of time before getting cover they need and think they already have.
- Funds should be able to provide automatic insurance to special categories of members regardless of age or account balance on a case by case basis to recognise that some workers are in high risk industries and may be unable or unlikely to access or afford insurance elsewhere. We would welcome the opportunity to work with the Government to develop a mechanism to ensure that these workers that are at high risk and/or have difficulty getting cover outside of superannuation are not adversely impacted by the Government's proposed change.
- Current settings should also be grandfathered for some legacy products with linked investment and insurance amounts – whole of life and endowment superannuation policies as examples.
- Cessation of death and TPD insurance for inactive accounts should only occur for balances below $6,000 to protect higher balance superannuation members from losing cover that they currently understand they have and can generally afford. As it stands, women leaving

the workforce to have children will be particularly vulnerable to losing cover because of this measure, at a time of their life when having it is most crucial. HILDA data[1] indicates that 60 per cent of women have a break from employment of more than 12 months and 40 per cent of them have a break of more than 2 years.

ASFA considers that the insurance measures in the package, if implemented as proposed, will remove access to insurance for many Australians who have a need for cover and would otherwise not have it. The indicative estimate of premiums removed from current risk pools also needs to be analysed in the context of future automatic insurance benefit designs and the impacts they may have on retirement outcomes before the package is implemented. Furthermore, many ASFA super fund, insurer and administrator members have expressed concern with the risk of administrative complexity related to the package. More specifically, clarity is needed with respect to election periods, member communications requirements and new opt-in and opt-out standards.

Younger Australians do receive benefits from "life" insurance in superannuation including in the context of death and/or terminal illness, total and permanent disability and temporary disability. The following outlines some of the broader benefits of insurance in superannuation in more detail:

- **Death/Terminal illness** - death cover in superannuation generally includes the ability for the member themselves to receive their insurance benefits up to two years in advance when a terminal illness is diagnosed.
- **Total and permanent disability (TPD) -** payments made to an individual who may never work again, assisting them to restore any likelihood of having a fulfilling life from that tragic point. Funds are also starting to incorporate rehabilitation programs into these benefits to help members get back to work if possible.
- **Temporary disability (income protection)** - many funds also provide these benefits in current automatic opt-out arrangements. Throughout a working life on average a fund member has a 25 per cent chance of having an income protection benefit being paid to them in the context of a temporary disability[2].

Insurance in superannuation is a long term benefit that manages risk particularly for those who cannot manage the risk individually due to a lack of information or due to cost.

We consider that the package would also benefit from an appropriate regulatory impact assessment that focusses on the long term. This assessment needs to take into account the impacts of increased health and income support costs falling on the government as well as the reduction in benefits for individuals from insurance in superannuation over the long term.

The superannuation industry itself commissioned research of this nature in 2017[3] which concluded that there is an overall net benefit to the government from the current policy settings over a 10 year period.

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[1] Household Income and Labour Dynamics in Australia Survey (HILDA) – Survey 2017.
2 ASFA Research and Resource Centre – The experience of individuals with insurance through superannuation - September 2017.
3 KPMG – Review of default group insurance in superannuation – September 2017.

Fee changes and account consolidation

ASFA supports measures that prevent the unnecessary erosion of people's retirement balances by fees. We strongly support removing barriers to people moving their superannuation (such as through banning exit fees), protecting the retirement balances of member balance accounts (through introducing member protection through fee caps) and increasing people's superannuation balances (through reuniting lost super with active accounts).

We consider that the ability of the ATO to reunite lost superannuation with an active account is a compelling reason why the ATO should move the money directly from an inactive account to an active account rather than going through the ATO. Our analysis suggests that balances below $6,000 are likely to be better off in an active account rather than the ATO, particularly given the Government's proposal to cap fees, because of the higher investment returns that a superannuation account is likely to make.

We also consider that there is merit in defining superannuation as being inactive after two years rather than the proposed 13 months to minimise the risk that superannuation is moved to the ATO while individuals are on maternity leave or temporarily overseas. We note that the Productivity Commission in their recent draft report reached the same conclusion.

ASFA is in favour of a mechanism which permits someone to elect to keep his or her superannuation in an account either explicitly or implicitly. This could be through a specific election, changing investment options, notifying the fund of a change of address or electing to maintain insurance – this should supersede receiving no contributions for 13 months (or as ASFA prefers two years).

B. Specific comments

1. Insurance for superannuation members – Schedule 2

1.1 No automatic insurance for new superannuation fund members under the age of 25

ASFA considers that younger Australians do have a need for insurance cover. Not having dependants, not having debts and potentially having risk protection provided by other insurance arrangements like workers compensation and motor accident schemes is often mentioned by commentators as a reason for not needing insurance in superannuation. On this theme, we note that those arrangements only apply in certain prescribed circumstances with no coverage for unexpected illness.

While we acknowledge that the majority of individuals under 25 may not yet have the family commitments to the same extent as those over 25, many of them do. In 2015-16 there were nearly 300,000 households in Australia containing around 450,000 employed persons with the household head less than 25 years of age.

There were nearly 60,000 dependent children in such households and in around 100,000 such households the household head had a spouse[4].

[4] ABS – Household Income and Wealth survey 2015-16

Evidence of claims provided to ASFA by its fund and insurer members highlights that many young people under 25 benefit from superannuation insurance payments. Two examples follow:

Death/Terminal illness

Jenny and David (not their real names) live in rural Australia with their two young sons aged 1 and 3. Jenny and David were married at 21 after they finished university together. They decided to return to their hometown and buy a house because of the rising costs of housing in a capital city.

Jenny was diagnosed with breast cancer at 24, and was unprepared for the news that it was terminal. Her immediate thoughts were about David and her children, and how they would cope without her. The financial impact was only one of the things she had to consider.

Jenny was fortunate that she received automatic life insurance when she joined her superannuation fund when she started working part-time while at university. Had she needed to have made a choice about life insurance, Jenny knows that she wouldn't have considered it necessary. No-one dies when they're in their 20's – it's only for older people.

Having life insurance allowed Jenny to prepare for the future, removing a significant financial burden from her thoughts. She knew that David would have to have relied on family and friends, and likely have to have sold their home in order to survive financially.

Income protection

Steve (not his real name) is 25 years old but was aged 24 at the date of his disability. He suffered from ulcerative colitis in his teens however this went into remission during his university years.

He was diagnosed with a malignant kidney tumour last year and underwent surgery to remove it. He recovered well initially after the operation, but after a few weeks his health deteriorated with a relapse of the ulcerative colitis. He remains off work and is having daily infusion treatments for the ulcerative colitis.

The insurer has engaged an occupational rehabilitation consultant to assist him however at this stage a return to work date has not been confirmed as a recent scan showed a possible relapse of the tumour. Steve is currently in receipt of approximately $3,000 per month and is eligible to receive this for up to 5 years. He has told his rehabilitation consultant that the insurance payments have been extremely helpful as they have allowed him to access some complementary treatments in additional to the medical regime that he would not otherwise have been able to afford.

It is likely that Steve would not have received these benefits if these events were to occur after the implementation of the proposed Protecting Your Super package, due to his prior conditions.

A superannuation fund that is an ASFA member has provided us with information on the frequency of claims paid to younger members. This fund, over the last 16 years has paid 1,036 insurance claims to those under 25 - 733 death benefits totalling $94.4 million and 303 TPD benefits totalling $23 million. For the death benefit claims, for those ages between 21 and 25, approximately 60 per cent of payments went to dependants highlighting that restricting cover to those below 25 will have

significant consequences for many.

For the majority of young people current arrangements provide a modest level of insurance at an affordable price. Average default insurance premiums for a 25 year old were approximately $240 pa in 2016[5]. The majority of accounts held by young people are also receiving contributions – in 2015/16 a total of approximately 1.7 million accounts for those under 25 received employer contributions out of a total number of accounts of approximately 2.9 million. Just as not all accounts receive contributions, not all accounts have insurances attached.

It is true that when a younger person has duplicate insurance because of duplicate accounts that the erosion of retirement savings might become inappropriate. However, the majority of young people do not have duplicate accounts; according to ATO records approximately 5 per cent of individuals under 18 have more than one account and those between 18 and 25, 30 per cent have more than one account[6]. ASFA agrees that policies are required to reduce the incidence of unnecessary insurance and we support those; however eliminating cover for the majority is not the solution.

Several funds have already adopted special arrangements for younger members to manage the balance between insurance benefits and the impact on retirement savings. These include in some cases having an opt-in arrangement similar to the government's proposal. We support trustees making those decisions based on their understanding of the specific needs of their members. Mandating all funds to do the same is another thing altogether and should it be necessary to go down this path ASFA recommends that the age based restriction apply to those under 21, as opposed to age 25, to minimise the unintended consequence of these changes and to reflect that 21 is the age by which many Australian's have commenced full-time employment

To recognise that there are risks associated with restricting the access to insurance for those under a certain age, some exceptions to the general prohibition are also required. Firstly, if insurance premiums are funded by an employer, automatic cover should be able to be provided regardless of age.

In addition, special classes of higher risk occupations – emergency services personnel, heavy industry, mining and construction employees should also be allowed to continue receiving insurance under the current arrangements. ATO figures[7] show that in 2015-16 the Australian workforce consisted of over: 59,000 police officers; 50,000 miners; 15,000 ambulance officers/paramedics; and 14,000 air transport professionals. All of these individuals and many of the potentially hundreds of thousands from a range of building and construction sectors would have challenges getting insurance if it were not for current settings.

We would welcome the opportunity to work with the Government to develop a mechanism to ensure that these workers that are at high risk and/or have difficulty getting cover outside of superannuation are not adversely impacted by the Government's proposed change.

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[5] Willis Towers Watson – Default Insurance Design – September 2016.
[6] https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/super-accounts-data/super-accounts-data-overview/
[7] ATO Annual Individual Income Tax Statistics – 2015/16

1.2 No automatic insurance provided to superannuation fund members with an account balance below $6,000

This measure creates issues for both new superannuation members joining a fund and for those already in a fund with insurance attached to their existing account.

ASFA understands that new members, regardless of age will have to wait until their account balance builds up to the $6,000 threshold to qualify for insurance. We consider it is not appropriate to link the need that people may have for insurance when commencing employment with their account balance – if it was, a lower balance would quite possibly reflect a greater need for insurance. Conversely, managing the cost and impact of providing cover is appropriate and while we support mechanisms relating to benefit design and contribution activity - blanket exclusion for balances below $6,000 is too blunt an instrument.

As for younger members, the claims paid to members with account balances below $6,000 are relevant for further consideration. Another fund that is a member of ASFA has paid 493 insurance claims to these lower balance members over the last 5 years – over $22 million in insured benefits. 274 of these were death claims, of which 57% went to financial dependants and 219 were disablement benefits, mostly TPD.

This same fund has also in the past ceased cover for low balance members but later reversed that decision because members continued to make claims on policies that they no longer held. Several cases had to be settled because of issues relating to insurance that a person had being cancelled – settling cases in the same way will be unsustainable with the current proposals and the fallout of declined claims will be catastrophic for all stakeholders.

As mentioned, we support insurance issuance and insurance cessation protocols applying based on account activity (contributions) as opposed to account balance. Therefore, new members joining a fund should be able to have automatic insurance issued regardless of the account balance as long as contributions are being made. Similarly, existing members with balances below $6,000 should not have their insurance ceased without their consent if the account is active. Adopting this protocol would also protect a special class of superannuation member that has a “risk only” account with a very low (and sometimes nil) balance from losing cover that they want because of their account balance being below $6,000.

1.3 No automatic insurance provided to superannuation fund members with an account that has been inactive for 13 months

ASFA supports a mechanism being introduced that allows a trustee to cancel insurances predicated by the superannuation account not having contributions for 13 months. In fact, the Insurance in Superannuation Code (the Code) of which ASFA is one of the owners includes an obligation on funds to do exactly that.

The Code obligation does have some differences that we would encourage the government to consider and revert to in this package.

Firstly, cessation of insurance in the Code only applies to insurance that has been issued on an automatic basis. All of the Code owners agreed when developing the Code that when a member has

made an active choice to have insurance attached to their superannuation either by applying for it, altering it or giving consent to it being retained they should not have their right to claim upon the policy removed by another party, potentially without their knowledge. Along the same lines, superannuation fund members who have a legacy Whole of Life and/or Endowment Superannuation policy with a combination of investment and life insurance components that are fully paid up should not be required to make further elections to retain the insurance due to contribution activity.

Secondly, the issue of a fund member being ineligible to claim on superannuation insurance because of a lack of contributions generally applies to income protection only. Like the Code, this protecting your super measure could break up the cessation measures by insurance type. The Code requires funds to cancel income protection insurances due to contribution inactivity but not death and TPD in all cases on the basis that those polices have greater value for a potential claimant and in the main premiums are met by earnings made by the fund.

Thirdly, to recognise that a number of risks exist for superannuation fund members having their insurances ceased in situations where they have simply taken a career break (having a family as the obvious example) the Code does not cease death and TPD insurance for account balances above the $6,000 balance for inactive accounts.

Finally, based on ATO statistics relating to the number of accounts held by Australian's – over 60 per cent have only one account so the majority are likely to hold only one insurance policy in superannuation. If duplicate accounts exist then in the main duplicate death and TPD payments will be made. ASFA agrees that duplicate accounts and duplicate insurances must reduce further. However ceasing insurances that individuals understand that they already have, in cases where it is attached to higher balance accounts where they may have even purchased it by choice or elected to keep it, is detrimental to all.

ASFA considers that the proposed package of insurance changes should be modified as follows to achieve a better balance between providing insurance benefits and minimising the impact this has on retirement savings:

- Changing the minimum age that automatic cover can be provided to new members to 21 (from the proposed age of 25)
- Allowing new members over a prescribed minimum age (21 as proposed by ASFA) being provided with automatic cover immediately upon joining a fund (without having to accrue a $6,000 balance)
- Introducing exemptions to allow funds to provide (and continue to provide) insurance for "special categories" of members regardless of age or account balance (higher risk occupations, when employers are covering premiums and for some choice and legacy products with linked investment and insurance amounts for example)
- Removing the obligation on funds to cease death and TPD insurance for inactive accounts when the balance is over $6,000 (in line with the cessation provisions of the Insurance in Superannuation Code of Practice).

2. Fees charged to superannuation fund members – Schedule 1

2.1 Low balance fee limit

ASFA supports the concept of protecting low balance accounts from fees and supports the introduction of fee caps.

Our members have asked for further detail about how the fee cap would work in practice and seek flexibility in how the fee cap might be applied.

We would also note that this will represent significant system changes that are likely to be difficult to achieve in the proposed timeframe. In this context, we consider that there may be merit in considering how funds might use a range of options to comply with the fee cap, for example the previous member protection framework might be used by some funds to meet the requirements of the fee cap while others may adopt a different approach.

Detailed observations on the draft legislation

We support protecting low balances from fees but note that the system changes created by the cap in its current form will be substantial.

We consider that there should be greater flexibility to permit superannuation funds to satisfy the intent of the proposal. For example, superannuation funds should be permitted to drop any dollar-based administration fees which would leave only the percentage-based investment fee and in some cases a percentage-based administration fee. For most if not all MySuper products this investment fee percentage would be significantly less than 1.5% for a six month period or 3% per annum and this would greatly simplify and reduce compliance costs.

The prospective nature of the balance test is problematic. It permits 'gaming' in the sense that once the balance day test takes place additional funds could be placed in the account but the fee limit would apply until the next balance test day. The balance test could be made retrospective as it was in the member protection framework or applied on an ongoing basis. In the above example where dollar fees are not applied to low balance accounts, the balance test could occur on an ongoing basis when fees normally apply, e.g. monthly.

It is not clear whether the investment cost or management expense ratio (MER) and indirect cost ratio (ICR) are intended to be included in the fee cap and our members have asked for this to be clarified. In addition, there is inconsistency in the terminology used between the legislation (fees charged) and the Explanatory Materials (fees deducted) with the latter having a much narrower application.

We question the application of the fee cap to pension products. The system changes required to adjust pension products may be significant but the incidence of low balance accounts in such products is likely to be low and the period for which they are low balance is likely to be short.

Some of our members have raised the question of whether the cap applies to the member's account in its entirety, i.e. the full 'beneficial interest' referred to in S.29T of the SIS Act, or whether it might in some circumstances refer to individual components of a member's account. For example, if a member has $5,000 in each of an Australian equities product, an international equities product and

an Australian fixed interest product, would the cap apply to each component or would the account be regarded as a single beneficial interest? We recommend that the total account be regarded as a single interest as the alternative is administratively complex and inconsistent with the stated intent of the proposal.

2.2 Ban on exit fees

ASFA supports this proposal and welcomes the fact that it will assist low balance members and those who wish to transfer or withdraw their benefit. However we do note that the Productivity Commission's draft report into Superannuation supports cost recovery for exits (p.476).

Detailed observations on the draft legislation

We recommend that the exit fee ban only apply to full benefit transfers. Many of our members permit partial withdrawals and the cost of processing partial withdrawals should not be placed on the broader membership. It may also lead trustees to withdraw the option of partial withdrawals due to the inequitable cost allocation between members who make full benefit vs partial withdrawals. This would be an unfortunate result for members.

A number of ASFA members are seeking clarification as to whether benefits with term limits or ongoing contribution requirements such as endowments, or products with explicit exit penalty and bonus arrangements, are intended to be caught under this measure.

It would appear that Family Law payment splits are caught by the ban on exit fees. We recommend that the existing Family Law fee arrangements be allowed to continue as the administration of Family Law valuations and payments is complex and the related costs should be attributed only to the parties involved and not to the broader membership.

3. Inactive low-balance accounts and consolidation into active accounts – Schedule 3

3.1 *Payment of inactive accounts below $6,000 to the ATO*

ASFA supports the reuniting of low balance inactive accounts with a member's active account unless the member wishes to maintain the low balance account for whatever reason, such as insurance or to accept a transfer or make a contribution in the future.

We consider that the ability of the ATO to reunite lost superannuation with an active account is a compelling reason why the ATO should move the money directly from an inactive account to an active account rather than it going to the ATO, particularly due to the higher investment returns available in a superannuation fund account.

ASFA members have identified administrative complexities for the transfer of inactive low balance accounts arising from the potential use of the existing Rollover Message as prescribed under the Superannuation Data and Payments Standards 2012 and the RSA Data and Payment Standards 2013. We recommend that the ATO work collaboratively with the industry to develop efficient delivery methods for such transfers, for example using the next version of the Rollover Message and its SuperStream enhancements due for release in November 2019.

Detailed observations on the draft legislation

Members should be able to elect to maintain a low balance account if they wish to. The current proposal only permits this in cases where the member wishes to maintain his or her insurance benefit. ASFA is in favour of a mechanism which permits someone to elect to keep his or her superannuation in an account either explicitly or implicitly. This could be through a specific election, changing investment options, changing address and notifying the fund or electing to maintain insurance – this should supersede receiving no contributions for 13 months (or as ASFA prefers two years).

Some trustees do not permit member contributions or rollovers while the member is not employed by an employer recognised by the trustee. There would appear to be no mechanism under the current proposal for permitting members of these funds with low balances to remain in the fund even if it was their express wish to do so.

We consider that there needs to be careful consideration over whether it is in a member's best interest to transfer of low balance accounts when the member only has one account and no alternative active account to which the inactive account could be transferred.

ASFA has conducted analysis into the relative performance of low balance accounts compared with those held by the ATO and we have found that for members with balances below $6,000 they are likely to be better off if their account remains with a fund due to the higher investment returns.

In addition, 13 months is a relatively short timeframe for the determination of inactivity and a member may have perfectly straightforward reasons for such inactivity including maternity leave, carers' leave and extended leave for travel or study. On the assumption that lack of contributions will be the primary determinant of inactivity the 13 months should be extended to two years and we note that the Productivity Commission's draft report recommends that the lost inactivity threshold be set at two years (p.61). This timeframe would provide greater assurance that the member is genuinely lost or disengaged.

Finally, the current system of defining lost, inactive and insoluble accounts and the addition of the low balance inactive category make an already complex area even more confusing. We consider that a comprehensive review of these categories and their application should occur once the revised regime is operational to address unintended consequences including in terms of definitions.

3.2 Consolidating accounts with the ATO into active superannuation accounts

We consider that the ability of the ATO to reunite lost superannuation with an active account is a compelling reason why the ATO should move the money directly from an inactive account to an active account rather than it going to the ATO. However should the money be required to go to the ATO or for the money that is already held there, we consider that the ATO needs to be accountable for reuniting the super benefit with people's active accounts as quickly as possible to ensure people can benefit from the higher returns funds provide.

We recommend that strict deadlines should apply to the Commissioner for the return of members' money to their active accounts.

Where a member has more than one inactive account but no active account ASFA supports consolidation directly into the most active account, with active as defined under the co-contribution payment rules (see c.5, Item 4, *Superannuation (Government Co-contribution for Low Income Earners) Regulations 2004*) or as the account with the most recent activity or the highest balance.

ASFA supports:

- Measures that prevent the unnecessary erosion of people's retirement balances by fees
- The proposal to ban exit fees
- The introduction of a fee cap but with greater flexibility than is currently envisaged.

Both proposals will require significant system and product changes and a longer implementation timeframe would assist members to make the necessary changes.

ASFA supports:

- Reuniting super with active accounts by the ATO directly (rather than going through the ATO)
- Defining inactive super as no contributions for two years rather than 13 months (consistent with the Productivity Commission) reflecting that women, in particular, have breaks from the workforce
- A mechanism that allows someone to elect to keep his or her superannuation in an account either explicitly or implicitly
- If inactive super goes to the ATO (and for the current stock), strict processing timelines to prevent funds being held at the ATO for lengthy periods.

If you have any queries or comments in relation to the content of our submission, please contact Senior Policy Advisor, Ken Whitton, [redacted] or by email at [redacted]

Yours sincerely

Martin Fahy

Chief Executive Officer