

Chapter Five

Life Insurance and the Superannuation Surcharge

Introduction

- 5.1 This chapter examines the impact of the portability regulations on:
- a) Life insurance arrangements offered by superannuation funds; and
 - b) Reporting and administration of the superannuation surcharge.

Life insurance arrangements

5.2 The Committee notes that many superannuation funds offer their members death and disability insurance coverage through group life insurance policies. Such policies offer fund members access to cheaper insurance cover than is available on an individual basis.

5.3 For example, in its written submission, Cbus indicated that its members have access to death and total and permanent disability insurance cover. Members may choose between 1 and 10 units of cover, with 1 unit being compulsory. In addition, employer-sponsored members in Cbus are able to access up to 4 units of insurance, without the need to undertake a medical examination.

5.4 However, during the inquiry, many parties expressed concern about the impact of the portability regulations on group life insurance policies.

5.5 For example, Cbus argued that group life insurance arrangements could be withdrawn due to the fear that members may actively select funds according to their insurance coverage. If that were to occur, Cbus noted that all superannuation fund members would be affected, even if they did not wish to exercise portability. To access coverage, members of a fund would need to provide medical information and undergo a medical test, leading to increased costs to the insurer and in turn the fund.

5.6 Cbus also noted that current automatic insurance arrangements give employees who suffer ailments such as asthma or diabetes access to affordable coverage. However, Cbus suggested that such employees could be either denied insurance cover under a portability regime, or required to pay loadings or have exclusions placed on their coverage.¹

1 *Submission 16, Cbus, p. 1.*

5.7 These concerns were also raised by the Law Council of Australia,² Mercer,³ and AAS in their written submissions. AAS reiterated that the life insurance arrangements of many superannuation funds may be undermined by portability, which could result in:

- Members paying higher premiums;
- Some members being required to take medical examinations;
- Some members being declined insurance or only able to obtain limited insurance; and
- Restrictions on, or even the loss of, other member benefits such as the 'continuation option' which allows a member to obtain some insurance cover after leaving the service of their employer, without the need to provide any medical evidence.⁴

5.8 The Committee notes that these issues were also raised in hearings. For example, Mr Watson from MTAA Super argued in the hearing on 31 July 2003 that MTAA Super has, by independent analysis, one of the most cost-effective group life insurance policies being offered by any fund. However, under a portability regime with churning of membership of up to 25 per cent in any given contract period, Mr Watson argued that MTAA Super's insurer would insist on a complete re-rating of the costs.⁵

5.9 Similar concerns were expressed by Mr Shallue from IAA⁶ and Mr Noble from Cbus, who argued that:

... the introduction of the portability regime, as it would stand, would threaten the ability of a fund, such as Cbus, to offer a group life scheme.⁷

5.10 The Committee also notes the evidence of Mr Korchinski from AAS in the hearing on 31 July that fund members may simply forget that they have access to insurance under their superannuation scheme, and be disadvantaged as a result:

a more significant issue is where, through ignorance, [a fund member] may transfer an amount or the majority of an amount and it does not leave enough in their previous fund to pay for insurance cover. If they move to a fund without cover, thinking that they did have cover in the new fund, and all of a sudden find that they did not have cover in the previous fund either,

2 *Submission 20*, Law Council of Australia, p. 4.

3 *Submission 17*, Mercer, p. 5.

4 *Submission 18*, AAS, p. 9

5 *Committee Hansard*, 31 July 2003, p. 7.

6 *Committee Hansard*, 1 August 2003, p. 40.

7 *Committee Hansard* 1 August 2003, p. 21.

then we have a consumer, a member, without insurance protection whatsoever.⁸

5.11 The Committee notes that the gazetted regulations introduce a provision allowing trustees to require members to leave a balance of up to \$5,000 behind in a fund. In the hearing on 1 August 2003, Mr Ward from Mercer noted that this requirement effectively solves the concern that individuals would not have sufficient funds in their superannuation account to maintain their insurance coverage.⁹ This was reiterated by Mr Murray from Treasury in the hearing on 13 August 2003.¹⁰

5.12 However, in the hearing on 13 August 2003, Mr Riordan from the Law Council of Australia raised concerns that trustees will nevertheless be exposed to liability for failure to inform members about risks associated with rolling over/transferring their benefits. Accordingly, Mr Riordan recommended that consideration be given to protective provisions for trustees in these circumstances.¹¹

The superannuation surcharge

5.13 The Committee notes evidence in the hearing on 1 August 2003 from Mr Jeffrey of Watson Wyatt¹² and from Mr Ward of Mercer that superannuation administrators have already faced enormous difficulties in administering the superannuation surcharge. As stated by Mr Ward:

I would also like to say a few things about the ‘S’ word—surcharge. Surcharge is a concept that I would say is totally alien to the superannuation environment. The legislation uses words that have never been used in a superannuation context before. It is like hammering a round peg into a square hole. There are cracks all through the peg. There are gaps down the sides and it has really only worked to the extent that it has because of a huge amount of effort put in by the tax office and a huge amount of effort put in by funds and their advisers to try to come up with a system that barely copes with the requirements. It is staggering along. When portability is introduced, the problems are magnified considerably.¹³

5.14 Reflecting Mr Ward’s evidence, the Committee notes that during the inquiry, significant additional concerns were expressed in relation to the likely added impact of the portability regulations on the administration of the superannuation surcharge. In its written submission, Mercer highlighted two difficulties in particular arising from the introduction of portability under the regulations:

8 *Committee Hansard*, 31 July 2003, p. 54.

9 *Committee Hansard*, 1 August 2003, p. 27.

10 *Committee Hansard*, 13 August 2003, p. 19.

11 *Committee Hansard*, 13 August 2003, p. 2.

12 *Committee Hansard*, 31 July 2003, p. 40.

13 *Committee Hansard*, 1 August 2003, p. 28.

- a) Determining how much of a rolled over/transferred amount relates to surchargeable contributions for the current year; and
- b) Handling surcharge assessments.

5.15 These issues are addressed below.

Determining surchargeable contributions for the current year

5.16 In its written submission, Watson Wyatt argued that under the portability regulations, if a partial roll over/transfer is made from a fund, the portion of the member's surchargeable contribution attributable to that roll over/transfer may not be clear, meaning that the fund may retain excessive or not retain sufficient surchargeable contributions when a surcharge assessment is received.¹⁴ This was reiterated by Mr Jeffrey from Watson Wyatt in the hearing on 31 July 2003:

If a partial withdrawal is taken and we have to report surchargeable contributions, a difficulty will be how much of the surchargeable contributions for that year relate to the partial withdrawal. The partial withdrawal could be in relation to a number of years of benefits. So there will need to be some way of apportioning surcharge contributions or determining whether they should be reported as moneys that have been transferred to another fund.¹⁵

5.17 In its written submission, Mercer argued that to cover such a contingency, industry protocols will need to be developed covering the surchargeable contributions for roll overs/transfers so that a standard practice applies. Preferably, the surcharge legislation/regulations should be amended to clearly set out the process.

5.18 Mercer further suggested that while this may seem like a minor point, from the perspective of those involved in the administration of the surcharge system, it is a major concern and the issue needs to be resolved at least 12 months before portability is introduced, in order to give funds the time to modify systems and procedures.

5.19 These points were also made by IAA in its written submission. IAA suggested that systems have been developed (with some difficulty) to cope with current surcharge reporting requirements. However, the IAA suggested that existing systems would need to be modified in order to cope with the reporting of contributions in a year in which a member makes a roll over/transfer, but continues to contribute to their old fund. IAA also recommended that should such changes to the surcharge legislation be needed, the industry should be given a further 12 months after those changes before portability is introduced.¹⁶

14 *Submission 12*, Watson Wyatt, pp. 2-3.

15 *Committee Hansard*, 31 July 2003, p. 37.

16 *Submission 15*, IAA, p. 4.

5.20 Given these concerns, the Committee notes the evidence from Mr Holland of AAS in the hearing on 31 July 2003 that the restriction on roll overs/transfers to allow a trustee to require a member to leave a balance of up to \$5,000 behind in the fund will go a long way to addressing the surcharge problem. At the same time, however, Mr Fitzpatrick from AAS argued:

It will help dissipate [the surcharge problem], but I think there would still be some issues. The pushing of money around the system that we already see—where the liability for surcharge on contributions is progressively passed on to different administrators—I think potentially will be exacerbated, because there will be more pushing of contributions around as there are partial payments pushed through the system.¹⁷

Handling surcharge assessments

5.21 In its written submission, Mercer noted that currently when a member leaves a fund, the member's total benefit is normally paid in cash (if the relevant requirements are met) or rolled over/transferred to another fund. Thus when a surcharge assessment is received by the fund for the exited member, there are normally no remaining assets for the member, it is clear that the surchargeable contributions have been rolled over/transferred elsewhere, and the ATO is advised accordingly.

5.22 However, Mercer noted that under a portability regime, there may be many occasions where part of the benefit is retained. Even where the whole withdrawal benefit is rolled over/transferred, further contributions may be received and by the time the next surcharge assessment is received there will again be a benefit in the fund. This benefit may or may not be large enough to meet the surcharge assessment.

5.23 Mercer submitted that in such instances, there are likely to be considerable arguments as to whether the fund is still 'the holder of the contributions' as the surcharge assessment may relate to contributions made in an earlier year which have already been paid out of the fund. In such a case, the fund is no longer the holder of the contributions and should not be liable to meet the assessment.

5.24 These concerns were reiterated by Mr Ward from Mercer in the hearing on 1 August 2003:

If, when a member leaves the employer, the whole benefit is transferred to another superannuation fund then it is fairly obvious that the new fund has become the holder of the contributions. But if we are transferring half of the member's benefit, which fund is the holder of the contributions that related to the surcharge assessment? Did the fund pay out the contributions it received 10 years ago or is it paying out the contributions it received this year or last year? There is no tying the legislation requirements for surcharge to what is actually being paid out here. How you would actually do that legislatively I have got no idea, it is just too complex. But we need

17 *Committee Hansard*, 31 July 2003, p. 53.

some sort of protocol established so that funds know there at least is a standard that we can all follow that asks, 'If you've transferred half your benefit, is that the first half of the contributions or the second half? Which year's contribution is it?' There is a lot of work involved in establishing that protocol. It is not going to be easy, but it needs to be done if surcharge is going to work at all. If it is not done we are going to have arguments between funds and we are going to have arguments between funds and the tax office.¹⁸

5.25 Once again, Mercer argued that amendments should be made to the surcharge legislation and procedures, as well as significant changes to funds' administrative systems to meet this difficulty, and that a period of at least 12 months would be necessary for the industry to amend administrative systems to cope with such a change.¹⁹

5.26 IAA also argued in its written submission that the reporting of surchargeable contributions and the receipt, analysis and payment of surcharge assessments is already complex, but that such complexities are only further magnified when benefits are rolled over/transferred.²⁰

5.27 In the hearing on 31 July 2003, the Committee Chair raised with Mr Korchinski from AAS whether a fund, on receipt of a surcharge assessment from the ATO, would be obliged to notify a fund member that he or she could not roll over/transfer all his or her money out of the fund, due to an obligation to meet the surcharge. In response, Mr Korchinski argued that possibly a trustee could make that decision. Alternatively, Mr Korchinski suggested there would have to be rules that would apportion the payment or the balance between the various funds, but that this would be a costly and cumbersome complexity.²¹

Consultation with the ATO

5.28 Given the concern regarding the impact of the portability regulations on handling surcharge assessment, the Committee requested that officers of the ATO provide the Committee with evidence on this matter during the hearing on 13 August 2003.

5.29 In his evidence to the Committee, Mr Jackson from the ATO indicated that the process of handling surcharge assessments is based on a process beginning in around October each year with notification of member contributions from a fund, through to issuing of assessment in around May. Difficulties occur where a roll over/transfer between funds occurs in that intervening period, and the ATO effectively

18 *Committee Hansard*, 1 August 2003, p. 29.

19 *Submission 17*, Mercer, pp. 6-7.

20 *Submission 15*, IAA, p. 4.

21 *Committee Hansard*, 31 July 2003, p. 54.

sends a surcharge assessment notice to the wrong fund. In that case, the original fund informs the ATO of the roll over/transfer, and a new assessment is issued.

5.30 In regard to an industry protocol to assist funds with handling surcharge assessments, Mr Casey from the ATO indicated that the ATO has developed a Super EC project which has been running for a little over two years which is designed to set up standard protocols for the transfer of information between funds. Most of the larger funds and administrators are already part of the Super EC group.

5.31 Given this evidence, Mr Jackson from the ATO submitted that:

... we cannot see any difference as a result of this change in the regulations. The only difference that I guess a number of people have observed is that there may be a more frequent movement between funds. That is possible, although it is up to others to estimate those kinds of numbers. But the actual core process that exists now would continue to operate in that environment.²²