BT Financial Group

28 May 2018

Manager, Regulatory Framework Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600
Email: superannuation@treasury.gov.au

Dear Sir/Madam

RE: Submission on "Protecting Your Super" consultation package

BT Financial Group (BTFG), part of the Westpac Group, welcomes the opportunity to provide feedback on the Government's "Protecting Your Super" package, consisting of the exposure draft *Treasury Laws Amendment (Protecting Superannuation) Bill 2018* (the Bill) and explanatory materials.

BTFG is broadly supportive of the proposed reforms designed to protect Australians' superannuation savings from undue erosion by fees and insurance premiums. As a founding member of the Insurance in Superannuation Working Group (ISWG), BTFG played an instrumental role in the development of the Insurance in Superannuation Voluntary Code (the Code). The Code is designed to improve the quality of insurance products and services distributed through super funds and covers a number of key areas including benefit design, communications, service considerations (particularly in relation to claims) and cessation of cover in certain circumstances when no contributions have been received for 13 months.

We believe the Code strikes the right balance between ensuring members have an appropriate level of insurance cover while protecting their level of retirement savings. We have therefore been calling for the implementation of the Code to be made compulsory, as it will ultimately benefit all members.

While BTFG supports the Government's intention to protect younger members and those with low balances and inactive accounts, we have some practical concerns around some of the proposed measures.

Our comments and recommendations on the key areas of the consultation package are discussed in the Attachment to this submission.

We would be pleased to discuss any element of our submission with Treasury.

Yours sincerely

Blake Briggs
Head of Government & Industry Affairs
BT Financial Group

BTFG comments on the consultation package

1. Cap on administration and investment fees of 3% a year on balances below $6,000

1.1 Implementation issues

BTFG supports the Government's proposal to limit the amount of administration and investment fees that can be charged to accounts with balances below $6,000 to 3% a year (i.e. 1.5% in a six-month period). However, there are a number of implementation issues, which we believe need to be addressed in order to improve member outcomes and the operational efficiency of this proposed policy.

Firstly, to allow compliance with the measure, the MySuper fee rules should be changed to allow a trustee to 'turn off' flat dollar administration fees for cohorts of consumers at the trustee's discretion, having regard to the trustee's obligation to act in the best interests of members and the relevant governing rules of the fund. In our view, the effect of this "compliance by design" amendment is that there will be no circumstances in which the total fees paid by consumers could be higher than the 3% annual cap, and in practice would likely be closer to 1% a year for MySuper funds that choose to take up this option.

Secondly, to facilitate a pragmatic approach to implementation, especially given the short timeframes involved, we believe the industry should be allowed to implement a rebate system instead of a forward-looking fee cap system. That is, trustees should be able to calculate a fee rebate and apply it in arrears on a regular basis, as well as to members who exit the fund, having regard to its various obligations under the *Superannuation Industry (Supervision) Act 1993* and general law, such that the total administration and investment fees deducted from accounts below $6,000 at the end of the period (or upon calculation of benefits paid during the period) do not exceed 1.5%.

Finally, we recommend that a transitional provision be established to allow superannuation funds in the process of migration (to another system within 12 months of commencement of the legislation) the ability to apply a rebate at the time of migration (or where a member exits the fund prior to migration) to ensure the maximum caps have not been breached. This would avoid the need for expensive changes to systems that are about to be decommissioned, whilst still achieving the Government's policy intent of protecting members with low account balances from undue fee erosion.

BTFG recommendation 1.1

BTFG recommends that:

- The MySuper fee rules be amended to allow a trustee to 'turn off' flat dollar administration fees for cohorts of consumers at the trustee's discretion, subject to legal and regulatory obligations being satisfied.
- The industry should be allowed to implement a rebate system instead of a forward-looking fee cap system, such that trustees are able to calculate a fee rebate and apply it in arrears on a regular basis, as well as to members who exit the fund in a manner consistent with its duties and obligations under statutory and general law.
- Trustees of superannuation funds in the process of migration (to another system within 12 months of commencement of the legislation) should be allowed to apply a rebate at the time of migration to ensure the maximum caps have not been breached.

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1.2 *Confirmation of which fees are to be included in the calculation*

BTFG considers that greater clarity is needed around which fees are included in the calculation of the fees for the purposes of applying the cap, with the aim of keeping it as simple as possible. In our view, the calculation should only include fees which are directly applied to members' accounts and exclude any indirect costs.

There should be a distinction between the definitions of investment fees for the purposes of this legislation and that which applies under *Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (RG 97). In our view, expenses that would otherwise be included in the calculation of the indirect cost ratio (ICR) should be excluded from the definition of investment fees for the purposes of this legislation.

In addition, performance fees would be difficult to include in the prospective fee cap calculation since they are not known in advance, yet are currently included in the 'investment fee' definition in the SIS Act which is referred to in the draft legislation.
In our view, the only way this could work in practice would be under a backwards-looking rebate system (as discussed in section 1.1 above) and even then it would be unwieldy to administer as performance fees are often not determined in the same six-monthly cycle.

BTFG recommendation 1.2

BTFG recommends that clarity be provided on the definition of fees for the purposes of this legislation:

- The fees that apply in relation to the fee cap calculation should only include those fees that are directly applied to members' accounts, and should exclude any indirect costs.
- The following fees should be excluded from the definition of investment and/or administration fee for the purposes of this legislation:
  - Expenses that are included in the calculation of the indirect cost ratio (ICR); and
  - Performance fees.

2. Ban on exit fees from all superannuation accounts

BTFG supports the Government's proposal to prohibit trustees from charging exit fees from all superannuation products from 1 July 2019, regardless of a member's account balance, when the member withdraws all or part of their interest in the fund.

In our view, this change could remove a disincentive for members to consolidate accounts or exercise a choice to roll their balance into another fund, which could reduce their exposure to duplicate fees across multiple accounts and thereby minimise undue erosion of their retirement savings.

We also support the prohibition on exit fees applying only for the cost of disposing a member's interests in the fund, thus excluding buy-sell spreads any costs associated with the disposal of selected assets (such as Term Deposit Break Fees).

BTFG recommendation 2.1

BTFG recommends that the amendments in Schedule 1 of the Bill prohibiting trustees from charging exit fees from all superannuation products from 1 July 2019 should be reviewed to ensure they do not limit member's access to specific investment options.

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3. Requirement to only offer opt-in insurance to: accounts below $6,000; new members under age 25; or inactive accounts (no contributions or rollovers received for 13 months)

3.1 Impact of opt-in TPD cover on young Australians

BTFG acknowledges and supports the Government's desire to protect the retirement savings of young members, as well as those with low account balances and inactive accounts from undue erosion. However, we are concerned about the impact that limiting TPD cover, in particular, to an opt-in basis is likely to have on younger Australians.

In our view, the removal of automatic cover for under 25s would disadvantage many young Australians who may not otherwise be able to obtain or afford TPD cover. They may not get cover at all (exclusions may apply) or they may have cover offered to them at a much higher price than a group arrangement would allow. This would significantly affect young members with health issues, as well as workers in blue collar and high risk and manual occupations.

Unlike Death cover, which younger people who do not have a spouse or dependents may not need, TPD is a particularly important and valuable benefit for all younger people, as they have a longer timeframe for which they need to protect against being unable to work ever again – i.e. the balance of their working lives. Also, younger people are more likely to participate in riskier pursuits, so they may find individual cover expensive or unavailable.

Behavioural economic research suggests that most young members will not take up insurance if it is offered on an opt-in basis (ASFA expects less than 10% of under 25s to opt in to insurance). This means most young people will slip through the safety net and will not have insurance cover if they are injured, at least until they reach 25 and their account balance reaches $6,000.

This is likely to exacerbate the impact of Australia's underinsurance problem, as those who experience injuries which prevent them working long term will fall back on the National Disability Insurance Scheme (NDIS) once their workers compensation has expired after 2 years, thus increasing the cost to Government.[1]

We therefore support the retention of the current opt-out model, but with hard limits placed on the amount of insurance premiums that can be deducted from default members' accounts. Consistent with the ISWG Code, we believe limiting premiums to a level that does not exceed 1% of members' salary would achieve the Government's desired policy outcome of providing insurance cover that does not inappropriately erode members' retirement income, but without the potential risk of disastrous outcomes that could result from many younger Australians going uninsured under an opt-in model.

BTFG recommendation 3.1

BTFG recommends the retention of the current opt-out model, coupled with hard limits being placed on the level of premiums that can be deducted from members' accounts (to say 1% of salary), as an effective

[1] The current level of underinsurance across the community negatively impacts individuals and families, as well as being a drain on government expenditure. According to Rice Warner's Underinsurance Report 2015, underinsurance for disability represents the greatest cost to government – estimated to be $1,258 million per year for total and permanent disablement (TPD) cover alone.

means of achieving the Government's desired policy outcome of protecting members' retirement savings and ensuring they are not inappropriately eroded by insurance premiums.

3.2 Two-year window for reaching $6,000

If the Government decides to proceed with its proposal to allow insurance to only be offered on an opt-in basis to new members under age 25, those with balances below $6,000 and inactive accounts, then BTFG believes there should be a two-year window to allow new members' account balances to reach $6,000.

By removing default insurance for new members, a number of members will be significantly disadvantaged – especially lower income earners and those not covered by compulsory contributions, who will typically take longer to reach the $6,000 threshold. Compounding the problem, lower income workers will also be most likely to struggle with affordability of underwritten insurance, being the alternative.

Under this modified approach, a new account (i.e. with a nil balance) would automatically be provided with default insurance cover on an opt-out basis and then:

- If the account balance reaches $6,000 within two years, the default cover would be retained;
- If the account balance does not reach $6,000 within two years, the default cover would be turned off at that point, after providing advance notice to the member.

We believe this is a sensible approach which would provide both an equitable outcome and appropriate protection for members new to the fund, particularly as most 'active' accounts with contributions (and possibly rollovers) coming in would likely reach $6,000 within the two-year timeframe.

BTFG recommendation 3.2

If the Government proceeds with its proposal to allow insurance to only be offered on an opt-in basis for account balances below $6,000, BTFG recommends that a two-year window be established to allow new member accounts to reach $6,000 before their default cover is potentially turned off.

3.3 Carve-out for employer-financed insurance arrangements

Some employers purchase group insurance on behalf of their employees and cover the cost of the insurance premiums – this is often provided by larger employers as an additional employment benefit.

BTFG considers that these employer-financed insurance arrangements should be completely carved out of the low balance and under 25 rules, given these employer-financed arrangements do not contribute to the erosion of members' retirement benefits (since the employer pays the premiums). That is, employers who wish to continue providing employer-financed insurance cover for their employees through superannuation on an opt-out basis should be able to continue do so, regardless of an employee's age or their account balance.

BTFG recommendation 3.3

BTFG recommends that employer-financed insurance arrangements, where the employer has purchased group cover for its employees and pays the premiums, should be carved out of the requirement to only offer opt-in insurance in certain circumstances.

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3.4 *Reinstatement of cover*

When a member reaches age 25 or their account balance reaches $6,000 for the first time, we believe the policy intent is that the trustee be obliged to provide default insurance cover without underwriting, just as they would if the member had just joined the fund. Otherwise the member would be better off joining another fund upon turning 25 or when their account balance reaches $6,000, where they will automatically be provided with cover.

We believe the legislation and/or the regulations should provide this clarification. To minimise the administrative and compliance impact on the industry, we suggest that the member's default insurance cover could commence from the start of the quarter after the member reaches 25 or their balance first reaches $6,000. The relevant disclosure would be provided and each impacted member would be provided with the opportunity to opt out of this cover.

BTFG recommendation 3.4

BTFG recommends that the legislation and/or regulations clarify that trustees are obliged to provide default insurance cover when a member reaches age 25 or their balance reaches $6,000 for the first time.

From an administrative perspective, we suggest that the member's insurance cover could commence from the start of the quarter after the member reaches 25 or their account balance first reaches $6,000.

3.5 *Active election by members to retain their existing cover*

BTFG believes that clarification should be provided, either in the legislation or regulations, that all superannuation fund members – not just those who are captured under the above circumstances (i.e. new members under age 25, those with account balances below $6,000 and inactive accounts) – should be allowed to make an active election (either written or verbal) to their superannuation fund to retain their existing insurance cover. For this purpose, an application for an underwritten insurance policy should also constitute an 'active election'.

A member making such an election would become a "choice insurance member" (as opposed to an "automatic insurance member"), which indicates that they have elected to take control of their insurance. As such, their cover should not be cancelled without their explicit instruction, even if their balance falls below $6,000 or no contributions/rollovers are received.

This is consistent with the recently-released ISWG Code which states that a person is no longer regarded as an "automatic insurance member" if they have advised their fund that they want to maintain their default insurance cover (which the fund must record).

Our proposed approach would ensure that individuals that have specifically established a separate superannuation account for the purposes of providing their insurance cover (potentially over and above the default amounts), would not lose their valuable insurance cover and assist trustees in exercising their duty to act in the best interests of their members.

BTFG recommendation 3.5

BTFG recommends that it would be in the best interests of members of superannuation funds if the legislation and/or regulations provide clarification that all superannuation fund members – not just those who are captured under the above circumstances – have the ability to make an active election to their superannuation fund to retain their existing insurance cover, even if their balance falls below $6,000 or no contributions/rollovers are received.

3.6 Alignment of election rules

BTFG considers that the election rules for inactive accounts should be aligned with the rules for small balances – that is, an election made before Budget night should remain valid after 1 July 2019.

We do not support the assertion in the explanatory material that an inactive account poses a higher risk than a low balance account that the insurance associated with the account may no longer be appropriate. In fact, the opposite could be true – individuals may have specifically established a separate superannuation account for the purposes of providing their insurance (often over and above the default cover), with sufficient balance in their account to cover insurance premiums for a number of years, without the need for further contributions or rollovers. These individuals have made a conscious decision about their insurance and should not have to make another election (in writing) to the fund to maintain their existing cover.

We therefore believe the election rules for inactive accounts should be the same as those for accounts below $6,000. That is, an election made before Budget night should be effective on or after 1 July 2019.

BTFG recommendation 3.6

BTFG recommends that the election rules for inactive accounts be aligned with the rules for account balances under $6,000.

4. Requirement to transfer accounts to the ATO where balances are below $6,000 or the account is inactive (no contributions or rollovers received for 13 months)

4.1 ATO should reunite existing accounts they hold with members' active accounts

BTFG acknowledges and supports the Government's desire to protect the retirement savings of members with low account balances as well as those who, for whatever reason, have not engaged with their superannuation and therefore may have (potentially multiple) inactive accounts.

However, prior to this reform commencing, we believe that the money already sitting with the ATO for years should firstly be transferred to members' active accounts. Such an account reunification process could push a member's balance in a fund above $6,000, which would negate the need for many accounts to be caught in the ATO sweep and avoid monies being transferred backwards and forwards (and insurance unnecessarily cancelled).

If the ATO is unable to process these transfers to active accounts by 1 July 2019, we believe the commencement date for this reform should be delayed until such time as they are able to do so.

BTFG recommendation 4.1

BTFG recommends that, prior to this reform commencing, the ATO should firstly be required to transfer accounts they currently hold to members' active accounts, to minimise instances of accounts being transferred backwards and forwards (and insurance being unnecessarily cancelled).

If the ATO is unable to reunite the accounts they currently hold with members' active accounts prior to 1 July 2019, we recommend that the commencement date of this requirement be postponed.

4.2 *Unintended consequences – including impact on insurance*

Whilst we support the protection of the retirement savings of members with low balances and inactive accounts, we believe there are a number of unintended consequences resulting from the proposed requirement to transfer certain accounts to the ATO as it is currently drafted, the greatest of which is the potential loss of insurance cover. We believe that trustees would have grave concerns in complying this requirement, as cancelling a member's insurance cover, and limiting their ability to claim in the future for any pre-existing conditions, would seem at odds with their obligation to act in the best interests of members.

Many members specifically choose to have multiple superannuation accounts with different providers – one in which to receive their Superannuation Guarantee (SG) and other contributions and another fund that has been specifically established to provide the member's insurance cover, often over and above the default amounts. These accounts are generally established/maintained with a sufficient balance to cover the insurance premiums for a number of years, without the need for further contributions.

In these circumstances, the person's superannuation account holding their insurance would be inadvertently swept to the ATO (once the period of 13 months of no contributions or rollovers has elapsed or their balance falls below $6,000) and the member would lose their valuable insurance cover. We do not believe this is an equitable outcome for members who are clearly engaged enough to have established a superannuation account for a specific purpose – nor does it help to address Australia's considerable underinsurance problem.

In our view, contributions and rollovers alone do not reflect a member's engagement with their superannuation – making decisions about the level or type of insurance cover they hold within the fund, as well as which investments or investment options they hold are equally valid indicators of a member's engagement. Requiring members to contribute to their account every year (which could be as little as $1) in an already compulsory system just so it does not become classified as 'inactive' is an outcome that should be avoided at all costs.

BTFG recommendation 4.2

BTFG recommends that:

- Accounts for which a choice has been made in relation to insurance (eg. where a member has made a decision to increase, decrease or retain their cover) should be excluded from the requirement to be automatically transferred to the ATO.
- Where a member has made an investment choice (either in relation to rebalancing their existing account balance or changing the investment allocation of future contributions), their account should be not be considered 'inactive' for the purposes of the 13 month inactivity test.
- All members should be allowed to make an active election to their fund at any time that they want their account to remain with the fund and not be swept to the ATO, regardless of their account balance or any subsequent period of inactivity (in line with existing process for lost member exclusions).

4.3 Exclusion of accounts in the pension/retirement phase

Under the current drafting of the Bill, superannuation accounts in the pension/retirement phase are captured under the requirement to be automatically transferred to the ATO when the balance falls below $6,000 or the account is inactive (no contributions or rollovers received for 13 months).

BTFG considers that accounts in the pension/retirement phase should be specifically excluded from this requirement for the following reasons:

- No new contributions or rollovers are allowed to be made into an existing retirement phase account. Any new contributions or rollovers must be used to start a new pension account. Alternatively, the original retirement phase account must be rolled back to the accumulation phase, the contribution or rollover added to it, then transferred back to the pension phase by starting a new retirement phase account. So for every retirement income stream that commences to be paid, they will all have to be transferred to the ATO after 13 months due to an absence of contributions or rollovers.
- Also, where a retirement phase account is being drawn down, there will come a time when the balance will eventually fall below $6,000. It would not make sense for the trustee, who has been paying the member a regular income stream (possibly for many years), to have to transfer the member's balance to the ATO at that point.

BTFG recommendation 4.3

BTFG recommends that the draft legislation be amended to specifically exclude superannuation accounts in the pension phase from the requirement to transfer accounts to the ATO where balances are below $6,000 or the account is inactive (no contributions or rollovers received for 13 months).

4.4 ATO should undertake timely reunification of accounts

The process and timing around the ATO reuniting consolidated amounts held for a person with their active superannuation account is of critical importance.

BTFG considers that the ATO should be required to take all reasonable steps to reunite lost and inactive accounts that have been transferred to it with members' active superannuation accounts in a timely manner, particularly given the existence of SuperStream and the fact that members' accounts are likely to receive greater investment earnings in the members' active account than would otherwise be applied while being held by the ATO.

We therefore support the Financial Services Council's position that the ATO should be required to sign up to a service level agreement (SLA) of 20 days in which to reunite an account it holds with a member's active account, rather than simply stating the ATO will undertake the transfer 'as soon as practicable'.

BTFG recommendation 4.4

BTFG recommends that the ATO be required to establish an SLA whereby it will make all reasonable attempts to transfer a lost or inactive account it holds with a member's active account within 20 days.