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PROTECTING YOUR SUPER PACKAGE
Submission to The Treasury on superannuation measures announced in the 2018/19 Federal Budget

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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INTRODUCTION

CHOICE welcomes this reform package as it represents a significant improvement on the status quo. For too long poor system design has led to a proliferation of accounts and serious erosion of people's retirement savings.

Reuniting people with their inactive superannuation accounts will help to fix one of the costliest problems facing Australians in saving for their retirement. The $6 billion in superannuation expected to go back to the accounts of three million members will have tangible benefits later in life. For some this will mean the difference between worrying about how they will afford the next energy bill or weekly shop and being able to retire in comfort.

The proposed improvements to life insurance targeting will deliver big benefits to younger people and people on low incomes. From inception the policy of default opt-out life insurance in superannuation has lacked a well-developed purpose. As a result, we have seen many people paying for insurance they do not know they have and in some cases do not require. We maintain that there is still work to do to ensure members are getting value for money and properly targeted protection for when they are unable to work due to disability.

The industry had ample opportunity to fix these problems but failed to deliver after more than a year of talk. The Life Insurance Code of Practice attempted to tackle many of these problems, but ultimately delivered an unenforceable code. The Code was unambitious and held back by self-interest. This sector has proven itself incapable of meaningful self-regulation and therefore we welcome the Federal Government's intervention to protect the best interests of consumers.

While we endorse the policy solutions as a whole throughout we have made recommendations on improvements to design to ensure it meets the intent without leading to unintended consequences. We also see the strong need for a broader review of the purpose of life insurance in superannuation when compared to the alternatives. The lack of clear policy direction in this space has led to a number of the problems this reform package has had to address.

Summary of recommendations

- **Recommendation 1:** The appropriate regulator monitor fee levels after the cap is introduced to ensure compliance and report on unintended consequences.
- **Recommendation 2:** The appropriate regulator monitor fee levels after the exit fee ban is introduced to ensure compliance and report on unintended consequences.
- **Recommendation 3:** The Federal Government conduct a review of this policy alongside a review of alternative models for providing protection for people who are unable to work due to disability.
- **Recommendation 4:** Introduce a community rating system to life insurance to prevent discrimination.
- **Recommendation 5:** The Federal Government conduct a review of this policy of default insurance in superannuation in four years' time, including analysis of how effective it has been in balancing the needs and costs of insurance for young people.
- **Recommendation 6:** Treasury explore methods for income mapping workers to ensure more appropriate insurance thresholds.
- **Recommendation 7:** Employers make superannuation guarantee payments at least monthly to assist income mapping.
- **Recommendation 8:** The Federal Government conduct a review of available data across industry and government to develop more targeted insurance offers.
- **Recommendation 9:** Place clearer obligations on trustees about what constitutes 'inappropriate erosion' under the SIS Act.
- **Recommendation 10:** That industry conducts consumer testing of all member communications to ensure people are informed of the implications of their decisions with regard to life insurance.
- **Recommendation 11:** Give the ATO adequate resources to consolidate accounts, deadlines for consolidation where an active account exists and a requirement to publically report against this metric.
- **Recommendation 12:** That the Federal Government put processes in place to allow appeal rights on beneficiary payments to be made through the Australian Financial Complaints Authority.

Fees charged to superannuation members

Fee caps

We support a cap on fees for low balance superannuation funds. However, we question the justification for setting the level at 3%. According to Rice Warner, on average superannuation fees are close to 1%.[1] In percentage terms a 3% cap would still see low balance consumers paying three times the average. Based on median returns on growth funds over the last decade, a 3% cap on fees would see funds break even in real terms.[2] When combined with other measures in this package people may be in a better position to grow their principal investments, but we see a need for a review of this policy to ensure the 3% cap is having the desired effect long-term.

We support twice yearly balance tests for the purpose of determining the 3% cap on fees. It is important these tests are done regularly as high fees can aggressively erode balances. We understand industry may seek to rebate fees charged in excess of the 3% cap. As a principle we maintain people should be no worse off than if the excess fees were not charged. For example, any rebate should include investment earnings on rebated fees.

We are concerned that some funds may attempt to game the 3% cap by shifting costs elsewhere. As a principle, the legislative framing to capture these fees should be worded as broadly as possible to prevent gaming. We also recommend that the regulator monitor fees and take action if there is evidence of fee caps being exploited.

Recommendation 1

- The appropriate regulator monitor fee levels after the cap is introduced to ensure compliance and report on unintended consequences.

[1] Rice Warner, 2017, 'Superannuation fees – How low can we go?', available at: http://www.ricewarner.com/superannuation-fees-how-low-can-we-go/

[2] Based on median returns of 5.4% in growth funds over the last ten years to 31 December 2017. Over this period a 3% fee cap and average inflation of 2.4% would see principal balances stagnate without additional contributions. Using Chant West returns data: https://www.chantwest.com.au/resources/a-stellar-year-for-super-funds

Exit fees

We support the introduction of a ban on exit fees. These fees represent a barrier to switching and competition. As part of CHOICE's qualitative survey on consumer's experience of superannuation, many respondents raised exit fees as complicating comparisons with other funds, with some calling for them to be abolished.[3]

While exit fees tend to be relatively small, as the Banking Royal Commission found, some can be excessive. One example from TAL Super saw a person charged a $16,189 exit fee, meaning he lost almost a quarter of his $68,000 retirement savings.[4]

As with fee caps we are concerned that some providers may seek to game the prohibition by increasing other fees that may be charged on exit. For example, under the proposal funds are free to charge for buy/sell spreads. These fees accrue when a fund buys into or sells an investment option, so will still be incurred when switching to another fund. Despite buy-sell spreads being disclosed alongside exit fees in product disclosures, these fees are extremely opaque. Often the exact buy/sell spread is not known and therefore not disclosed in a product disclosure statement; a person is instead left with a percentage-based range they may be charged on exit. It is unlikely most consumers have any understanding of what the term buy/sell spread means, let alone the circumstances when it will be charged.

As these fees also tend to be charged on a percentage basis, consumers are required to undertake a calculation to understand the impact in dollar terms of moving funds. Given what we know about adult numeracy levels in Australia, this is a task which many people will struggle to perform. The most recent study on adult numeracy found 21.5% of people lack the ability to perform calculations with whole numbers and common decimals, precents and fractions.[5] These are the exact skills required to make sense of a percentage-based fee. Again, we recommend monitoring take place to ensure compliance and map any unintended consequences flowing from the exit fee ban.

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[3] The survey was sent to a group of CHOICE consumer supporters who have previously expressed an interest in financial services policy. The survey ran from 9/08/2017 to 21/08/2017. 2508 responses were recorded.

[4] The Guardian, 2018, 'Banking royal commission: AMP advice led to loss of quarter of super account', available at: https://www.theguardian.com/australia-news/2018/apr/23/banking-royal-commission-amp-advice-led-to-loss-of-quarter-of-mans-superannuation

[5] ABS, 2013, 'Programme for the International Assessment of Adult Competencies, Australia, 2011-12', available at: http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/4228.0Main%20Features202011-12?opendocument&tabname=Summary&prodno=4228.0&issue=2011-12&num=&view=

Recommendation 2

- The appropriate regulator monitor fee levels after the exit fee ban is introduced to ensure compliance and report on unintended consequences.

Insurance for superannuation members

The purpose of insurance in superannuation

Before turning to the specific proposals, it is worth considering the purpose insurance performs in superannuation. The need to provide economically for people who through death or disability are unable to provide for themselves or their dependents is a fundamental requirement of any good society. The question that then needs to be asked is, what is the most efficient and equitable way to provide protection?

Forcing this protection into the private realm has meant we are left without universal cover, because many people will not be able to afford to pay or see the value of insurance in the first place. Also, the adequacy of a person's cover is dictated by their ability to pay. Privately provided life insurance creates a need to extract a profit. In some markets the effort to extract profit can drive pro-consumer competitive outcomes, such as better designed or more efficiently offered products.

Life insurance in superannuation is clearly not one of those markets. Behavioural biases work against consumers making rational decisions over their insurance needs. Behavioural economics recognises that consumers have limits on the amount of information they can take in; are affected by presentation; tend to be poor at anticipating the future; and are more concerned about losses than gains.[6] Given life insurance is often complex and the benefits in the future if at all, consumers can be particularly poor at assessing their needs in relation to an insurance policy.

These issues can be compounded by the fact that life insurance in superannuation is a 'bundled' product. From a behavioural perspective, bundling, which can result in complex pricing, increases the costs of searching for the preferred choice, and ultimately impacts

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[6] Office of Fair Trading, 2010, 'What does Behavioural Economics mean for Competition Policy?', March 2010, p. 5

someone's ability to make an informed decision.[7] This is due to the need for consumers to obtain information and learn about the various quantities, quality and price combinations offered by a range of suppliers. Studies have shown that consumers make systematic errors when assessing the worth of bundled goods and/or services.[8] These errors may advantage producers at the expense of consumers.[9]

These behavioural biases make consumers poor judges of what is an appropriate life insurance product. Indeed, four in five consumers have never analysed the type and amount of life insurance that suits their own circumstances.[10] The level of consumer engagement with these products is extremely low and is therefore incapable of driving competition in the interests of consumers.

Few people are making an informed decision about their life insurance. Instead trustees are given a wide discretion when designing products, other than broad requirement to act in 'member's best interests'. This has led to the development of policies which may be beneficial to the 'average' member, but are inappropriate for individuals, particularly younger people, people on low incomes and parents taking career breaks.

Legislative intent

It is important to reflect on the purpose of default insurance in superannuation. In the explanatory memorandum for the MySuper reforms the purpose was described as providing:

> *"…benefits [to] protect members against the risk of not being able to accumulate sufficient retirement savings, for themselves or their dependents, due to having to cease work as a result of injury or illness or as a result of death."*[11]

While there is mention of protecting against the risk of not being able to accumulate sufficient retirement savings, there is no explicit reference to the degree to which this risk should be

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[7] Papandrea, F., Stoeckl, N., Daly, A., 2003, 'Bundling in the Australian telecommunications industry', *Australian Economic Review* 36 (1), 41-54.

[8] Heeler, R.M., Nguyen, A., Buff, C., 2007, 'Bundles = discount? Revisiting complex theories of bundle effects', *Journal of Product and Brand Management* 16 (7), 492-500.

[9] Estelami, H., 1999, 'Consumer savings in complementary product bundles', *Journal of Marketing Theory and Practice*, 7(3), pp. 107-114.

[10] Zurich Australia, 2014, 'Australians and Life Insurance: Misinformed, Misinsured?', Sydney.

[11] *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012*, Explanatory Memorandum, p.21

protected against. In combination with the insurance covenants in the *Superannuation Industry (Supervision) Act 1993* there is specific direction to:

> *"only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries."*[12]

It is clear from the legislation that the quantum of insurance offered through superannuation needs to balance the risk of insufficient retirement savings due to disability or death while not inappropriately eroding the retirement savings of a fund member. Unhelpfully there was very little prescription over how to balance these two competing interests. As a result, we have seen a proliferation of policies that do not benefit some members.

Insurance reforms

Overall, we support the intent of these measures. There are clear and strong reasons for making insurance opt-in for under 25s, low income people and those with inactive accounts. The estimated $3 billion savings to these people of the reform will help people save for retirement with dignity.[13]

However, we believe there is a missed opportunity in ensuring those within these categories who still need insurance will end up with adequate protection. Again, this is not to say a privately provided insurance scheme is the most efficient way to provide this protection. Indeed, many would be better served by alternatives, such as a Disability Support Pension (DSP) that provides an adequate income to all who need it.
While the proposed measures have attempted to address some of these problems, we see value in a broader review to assess the adequacy and efficiency of providing life insurance through superannuation. This review should also assess the adequacy of funding for and access to alternatives, such as the DSP.

[12] *Superannuation Industry (Supervision) Act 1993,* s52(7)(c)
[13] O'Dwyer, 2018, 'Encouraging and rewarding Australians by protecting your superannuation', available at: http://kmo.ministers.treasury.gov.au/media-release/050-2018/

Recommendation 3

- The Federal Government conduct a review of this policy alongside a review of alternative models for providing protection for people who are unable to work due to disability.

Young people and insurance

For most under 25s life insurance, particularly death cover, will offer little to no value. However, there are a minority groups within this demographic, such as those with dependents, who could benefit from cover. The policy as stated does not bar these groups from electing to take up insurance either inside or outside of insurance. It must also be kept in mind that there are other protections, such as health insurance, Medicare, workers' compensation schemes and social security to assist those unable to work or to rehabilitate back into work.

We are yet to see what the experience will be for under 25s who attempt to take out insurance for themselves and the degree to which those in high risk occupations are able to access affordable cover if these changes go through.

We see a need to design consumer protections which ensure access and affordability for this demographic are not a barrier. Australia's private health insurance system is based on a 'community rating' which means everyone pays the same premium for their health insurance and health funds are prevented from discriminating against members based on health status, age or claims history.

Critics may claim this runs against the risk-based pricing inherent in life insurance. However, the policy intent behind life insurance in superannuation appears to be constructed on a principle of universality. The life insurance industry is also getting direct support from government through legislation that requires that their product is offered by default to Australian workers. Again, there is policy ambiguity around exactly why people are defaulted into life insurance and we see scope to review the efficiency of this policy as a whole compared to the alternatives. However, if the life insurance sector wishes to continue to benefit from this near universal policy, we maintain that a community rating system should exist to ensure those that wish to take up cover are not discriminated against, at least for those who will not be automatically opted in under this policy change. This may have cost implications but to ensure equity they should be worn across the insured group.

Recommendation 4

- Introduce a community rating system to life insurance to prevent discrimination.

Disengagement with insurance

Disengagement with decisions around life insurance and superannuation is another factor working against some young people seeking insurance. These decisions are made more difficult by the paucity of existing information about the cost and value of insurance. One of the few positives to come from the Life Insurance in Superannuation Code of Practice was a commitment by industry to simplify this information and provide it at more targeted occasions. While this commitment did not go nearly far enough and is not enforceable, with individual pricing information left off disclosures, this is a step in the right direction.

Better information will aid people to decide whether they should opt into insurance. However, this will need to be accompanied by a greater effort on the part of funds, employers and employee representatives, particularly those in high risk industries, to ensure those that have a need have adequately considered insurance as an option. It is unknown how successful these groups and improvements to information will be in communicating to this demographic. Therefore, we propose that the adequacy of these measures be incorporated into an overarching review of the policy default insurance within superannuation in four years' time.

Recommendation 5

- The Federal Government conduct a review of this policy of default insurance in superannuation in four years' time, including analysis of how effective it has been in balancing the needs and costs of insurance for young people.

People on low incomes and insurance

The proposed $6,000 superannuation balance threshold, below which people are not automatically defaulted into life insurance appears targeted at low income people who would otherwise be over insured. However, there are people who may meet this threshold for whom life insurance may still be inappropriate, likewise there may be people on higher incomes who enter the Australian workforce later in life who may miss out on default insurance until they have a sufficient balance. We maintain there are more targeted ways to meet the policy objective of ensuring low income people are not over-insured while high income people are not under-insured.

As the Productivity Commission found in its recent report on the impacts of life insurance on superannuation balances:

> *"The effects on retirement balances are worse for members on low incomes, especially those with intermittent labour force attachment who continue to have premiums deducted from their accounts while not contributing to their super. The retirement balance erosion for these members could reach 14 per cent ($85 000), and well over a quarter for some disadvantaged members with duplicate insurance policies ($125 000)."*[14]

Given the benefits paid under some default insurance policies do not exceed $85,000, we question if the right balance has been struck for low income people.[15]

For some people on low incomes, the DSP would more than replace their household income if they were unable to work due to disability. Mean household income for the 20% of Australians on the lowest income quintile is $421 a week or $21,892 a year.[16] Maximum payment rate for DSP for a person over 21 is $23,597.60 a year. If the purpose of Total and Permanent Disability insurance within superannuation is to replace income lost due to incapacity, then for 20% of households a default insurance product provides in excess on income replacement levels and will likely erode retirement savings at a rapid rate.

It is likely that many households within this income bracket are already reliant on social security benefits and may have no or inconsistent superannuation guarantee payments. However, it is likely some of these people will have superannuation balances above $6,000 or may reach that $6,000 threshold and no longer have regular contributions. Under the proposed policy, low income people in these situations are likely to end up over-insured and have retirement balances severely eroded due to insurance premiums.

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[14] Productivity Commission, 2018, 'Superannuation Assessment Draft Overview'p.21

[15] For example, default TPD cover at REST is fixed at $28,600 for people up to 60 years of age. Available at: https://www.rest.com.au/NEW-Document-Library/Guides/Member/RES0254_REST_Super-Insurance-Guide-FA_WEBSAFE.PDF

[16] ABS, 2017, 'Household Income and Wealth, Australia, 2015-16', available at: http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2015-16~Main%20Features~Changes%20in%20Income%20Over%20Time~9

The problem of low income over-insurance and high income under-insurance would be better addressed by a policy of income mapping to ensure people have appropriate cover. Between the ATO and the superannuation funds, there is adequate data to map the expected income levels of workers. A much more targeted policy could be developed if this data were able to be harnessed to provide appropriate levels of insurance.

More broadly there appears to be a lack of data used across the sector to better understand the needs of members. Insurance products could be much better targeted if there was greater data sharing around key points in people's lives, such as parental leave, job changes and number of dependents. Mapping income data is also hampered at the fund level by outdated obligations on employers to only make superannuation guarantee payments quarterly. We maintain there should be greater data sharing across government and industry to help facilitate more targeted insurance offers.

Recommendations 6, 7 and 8

- Treasury explore methods for income mapping workers to ensure more appropriate insurance thresholds.
- Employers make superannuation guarantee payments at least monthly to assist income mapping.
- That the Federal Government conduct a review of available data across industry and government to develop more targeted insurance offers.

Impact on premiums

We are concerned that elements of industry have sought to muddy the waters on the expected impact of these changes on premiums. Commentary from KPMG appeared to contradict its own research by claiming in the media that insurance premiums could rise by as much as 30% due to the proposed changes.[17] A KPMG report released in late 2017 found that if insurance for under 30s was made opt-in, not just under 25s, the expected increase in premiums would be a more modest 5% to 15%.[18]

[17] The Australian, 'Super life insurance fees 'could rise 30pc', available at: https://www.theaustralian.com.au/business/financial-services/life-insurance-fees-could-rise-30pc-super-life-insurance-fees-could-rise-30pc/news-story/7f3de77bf6ab791caeaf47cc4b7cad34?login=1

[18] KPMG, 2017, 'Review of default group insurance in superannuation' p.ix, available at: https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/default-group-insurance-superannuation-review.pdf

These conflicting figures may in part be explained by a greater reduction in duplicate accounts under the Federal Government's policy. From a member's perspective this 30% figure is misleading, given there are 10 million unintended multiple accounts with an estimated $2.6 billion in annual fees and insurance.[19] This means that many people are currently paying for two or more insurance policies, reducing these duplicates will obviously greatly decrease a member's total insurance spend. The savings from closing these duplicates are likely to more than offset any potential premium increase. While total insurance spend may go up for those with only one account, these people are currently the beneficiaries of cross-subsidisation due to less engaged people paying extra across duplicate accounts. This is clearly unfair and the Federal Government's steps to stamp out duplicate accounts should be implemented.

Inappropriate erosion

The covenant under the Superannuation Industry (Supervision) Act 1993 (SIS Act) needs to be improved so that trustees have a better understanding of the meaning of 'inappropriate erosion'. The current understanding is unsophisticated; CHOICE has heard from some industry players who described it simply as not eroding the principal. This is an unsatisfactory definition. People do not delay spending and invest in a superannuation product so their money will simply maintain the value it had on entry. People invest, particularly in a compulsory superannuation environment where their access to earnings are delayed until retirement, with the expectation of return on the principal.

An expanded definition is necessary to give further protection to peoples' retirement savings. The proposed policies go to protecting those with inactive accounts, some low income and under 25s, however there are people outside of these groups that may require further protection. As an example, most 25-30 year olds do not have dependents, so they have a lower need for some types of insurance.[20] This demographic is also in the early years of paid employment, some of which is inconsistent, with fledgling superannuation balances. The need for certain types of insurance, such as death cover and in some cases income protection is less clear for this demographic. We maintain that there should be clearer obligations on trustees about what constitutes 'inappropriate erosion' for demographics like this one.

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[19] Productivity Commission, 2018, 'Why our Super system needs to be modernised', available at: https://www.pc.gov.au/inquiries/current/superannuation/assessment/draft

[20] ABS, 2014, 'Marriages and divorces, Australia, 2013', ABS cat. no. 3310.0. Canberra: ABS.; ABS, 2015, 'Births, Australia, 2014' available at: http://www.abs.gov.au/ausstats%5Cabs@.nsf/0/8668A9A0D4B0156CCA25792F0016186A?Opendocument

Recommendation 9

- Place clearer obligations on trustees about what constitutes 'inappropriate erosion' under the SIS Act.

Communication of changes to insurance cover

The legislation requires a trustee to provide written notifications to members with inactive accounts. This will have the interpretation given under the Acts Interpretation Act. Treasury has indicated there will be further prescription on what form this notification will take in the regulations. These need to be consumer tested to ensure a higher level of consumer comprehension of the impacts.

Supporting this are the information requirements under the Insurance in Superannuation Code of Practice. Trustees are required to inform consumers on a number of occasions about the impact of losing insurance.

For consumers who elect to keep insurance this will be an 'enduring election'. Again, consumer testing is required and protections put in place to ensure these elections contain active, informed consent.

Recommendation 10

- That industry conduct consumer testing of all member communications to ensure people are informed of the implications of their decisions with regard to life insurance.

Inactive low-balance accounts and consolidation into active accounts

We broadly support this measure as it will see billions of dollars flowing into the active accounts of people. However, we are concerned that the proposal contains no timeframes for the Australian Taxation Office (ATO) to conduct a consolidation. The ATO has a number of competing priorities – giving it this new responsibility without additional funding or a timeframe in which to complete the activity risks delays. There is also a threat to the ATO's reputation if a belief forms that the regulator is delaying consolidation in order to boost government finances. This reputational risk is not good for building important tax payer trust in the institution. We recommend the ATO be given adequate resources to complete this new function, that it have deadlines for consolidation where an active account exists and that it report against this metric.

We understand that some industry members prefer a system where the ATO directs consolidation by the funds rather than collect and consolidate at the regulator level. On balance we prefer the approach of greater ATO control. While leaving savings with the funds for longer gives greater opportunity to earn returns, these returns are likely to be small in quantum. In reality some funds will not be able to be re-united. We maintain that where consolidation is not possible greater public policy aims would be achieved by the ATO holding these savings than the savings being eroded by a superannuation fund.

Recommendation 11

- Give the ATO adequate resources to consolidate accounts, deadlines for consolidation where an active account exists and a requirement to publicly report against this metric.

ATO acting in the place of the trustee

Another concern with the ATO holding a person's savings is what happens when that person dies. The legislation contemplates that the Commissioner must pay the money to the deceased's beneficiaries if "the Commissioner is satisfied that the original fund would have paid the amount to beneficiaries". Currently trustees have this duty and disputes over who are the appropriate beneficiaries are commonly escalated to the Superannuation Complaints Tribunal (SCT). It is unclear from the proposal what role the ATO intends to play in resolving these disputes or if existing administrative appeals processes are adequate to handle these cases.

Given the well-developed process that already exist in consumer facing external dispute resolution schemes such as the SCT (soon to be the Australian Financial Complaints Authority (AFCA)), we maintain that this is a better forum for deciding these escalated complaints. As such, it may be preferable for the last acting trustee to make a decision regarding these payments or for the ATO to subject itself to AFCA for the purposes of appeal.

Recommendation 12

- That the Federal Government put processes in place to allow appeal rights on beneficiary payments to be made through the Australian Financial Complaints Authority.