29 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,

Protecting Superannuation – Insurance for Superannuation Members
Treasury Laws Amendment (Protecting Superannuation) Bill 2018

Energy Industries Superannuation Scheme Pty Ltd would like to provide this submission in response to the exposure draft *Treasury Laws Amendment (Protecting Superannuation) Bill 2018* (the **Exposure Draft Bill**).

About EISS

Energy Industries Superannuation Scheme Pty Ltd is the trustee of the Energy Industries Superannuation Scheme (**EISS**). EISS comprises two funds: one defined contribution fund which is open to the public; and one defined benefit fund which is closed to new members. EISS is an APRA regulated superannuation fund servicing 22,000 members in the state of New South Wales. Over 60% of our members work in the energy industry and many of their occupations are considered dangerous. EISS's defined contribution fund offers an APRA regulated MySuper product that provides default Death and Total and Permanent Disablement (**TPD**) insurance cover. The default Death and TPD insurance provided is tailored to cover hazardous occupations to cater for the needs of EISS members who are engaged in such dangerous occupations.

Key Points

EISS is of the view that insurance in superannuation has a crucial role to play to adequately protect the interests of our members in the unfortunate event of illness, injury or death.

ASIC's recent release on life insurance advice in Australia details that life and disability underinsurance in Australia is significant and requires policy measures to close the 'underinsurance gap'[1].

EISS understands that the rationale for the changes proposed by Schedule 2 to the exposure draft *Treasury Laws Amendment (Protecting Superannuation) Bill 2018* (the **Insurance Proposal**) is to protect the retirement savings of young people, those with inactive accounts

[1] ASIC, Report 413, *Review of retail life insurance advice*, October 2014, at page 49, quoting the *Financial System Inquiry: Interim Report*, Commonwealth of Australia, July 2014, section 3:78 – 3:79;

and those with low balances from account erosion by reason of insurance premiums on insurance policies they may not be aware of or may not need[2].

EISS understands that the Insurance Proposal, which is stated to come into effect from 1 July 2019, proposes to change default insurance cover to cover provided on an opt-in basis for superannuation members:

- whose account balances are less than $6,000;
- who are under the age of 25 years (and over 18 years); or
- who have not contributed to their superannuation account for the previous 13 months[3].

EISS is of the view that the Insurance Proposal does not adequately address the competing interest of ensuring superannuation members have adequate insurance cover in place but rather would exacerbate the problem. EISS requests that Treasury consider the impact of the Insurance Proposal on members who may find themselves in the situation where they need to make a claim or re-enter the market after their insurance cover is cancelled, as demonstrated below by reference to the EISS membership experience in particular.

EISS has undertaken industry analysis[4] (annexed as Appendix A) which concludes that the Insurance Proposal will have the effect of increasing the cost of insurance provided through superannuation. Since group life insurance through superannuation is provided on a pooling model, it is expected that reducing the size of a pool of superannuation members insured under a group life policy as well as removing younger members from the pool, will increase the premium costs per insured person. According to EISS's industry analysis, the likely increase in premium cost would then have the unintended consequence of increasing the level of superannuation benefit erosion.

Additionally, EISS has some concerns with the timing of the implementation of the proposed changes and its impact on administration resources and costs.

1. EISS Membership Experience

<u>1.1 Blue Collar Workers</u>

Over 60% of EISS members are employed by employers in the electricity industry. These members are engaged in blue collar work that predominantly involves jobs that insurers consider to be "hazardous occupations". Unfortunately, EISS members who are engaged in these hazardous occupations are at a greater risk of injury or death than people employed in different industries and less hazardous occupations.

EISS has specifically negotiated a customised group life insurance policy that caters for blue collar members by providing Death and TPD cover that covers hazardous occupations.

As a result of the Insurance Proposal, EISS members who are employed in hazardous occupations and are no longer covered by EISS default insurance, will likely have difficulty re-entering the death and TPD insurance market. These members are likely to face underwriting declines, exclusions and/or premium loadings to account for the risk of their hazardous occupations to the insurer.

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[2] Australian Government, The Treasury, *Budget Measures 2018-2019: Budget Paper No. 2*, Part 1: Revenue Measures, at page 36;

[3] *Exposure Draft Explanatory Materials, Treasury Laws Amendment (Protecting Superannuation) Bill 2018* at page 12 (**Exposure Draft Explanatory Materials**);

[4] KPMG, Letter to EISS, *Analysis to support EISS' submission on the proposed changes to insurance within the Federal Budget*, 23 May 2018, at **<u>Appendix A</u>**;

1.2 Coverage for suicide

Just under half of the membership of EISS is based in regional New South Wales. Younger members aged between 18 and 25 years who work in regional areas and are engaged in predominantly blue collar work (as detailed above), are more prone to self-harm and suicide. From the member best interest point of view, EISS has specifically negotiated an insurance policy that covers claims for member deaths caused by suicide. Not all superannuation funds offer insurance for suicide.

If EISS members aged between 18 and 25 years have their cover cancelled because of the Insurance Proposal, it would be difficult for these members when re-entering the market to obtain insurance that would cover death in these circumstances. As noted in detail with reference to an EISS member case study at point 1.4 below, the cost of supporting any dependants that these members would leave behind in the unfortunate event of their death, would fall back to the taxpayer to cover.

1.3 Superannuation Account Balances

It is our understanding that the Insurance Proposal requires members who are between the ages of 18 and 25 years to specifically elect to opt-into the default group life insurance arrangements currently provided to these members automatically[5]. Similarly, superannuation funds will be required to notify members whose account balances fall below $6,000 that they must elect to opt back into the default insurance arrangements[6].

Younger members aged between 18 and 25 years comprise just under 10% of the EISS public offer division (naturally excluding the EISS Pension division). EISS members aged between 18 and 25 years have an average of just over $12,800 in their superannuation accounts.

EISS understands that the age limit and the minimum balance are set as alternative scenarios that activate the requirement for a superannuation fund to notify a member that their insurance cover will be cancelled if they do not elect to opt-into default insurance cover. Accordingly, an EISS member aged 21 years with a superannuation account balance just above $12,800 (as at 1 July 2019) will be captured by the Insurance Proposal and be required to opt-in to default insurance cover. This is despite the fact that this member would have twice the value of the $6,000 amount labelled as the “low balance” benchmark in the Exposure Draft Bill.

EISS is of the view that the younger EISS members aged between 18 and 25 years do not fit the model for the typical superannuation member account that is considered to be at risk of account erosion as detailed in the explanation of the key rationales for the Insurance Proposal[7].

1.4 Impact on potential claimants - Claim Case Studies

EISS accepts that Australians do not like to pay insurance premiums, that is, until they are in a position where they need to lodge a claim. However, if superannuation members no longer have insurance but have suffered an injury, illness or death with dependants to support, then the cost of supporting these members or claimants will revert to the taxpayer instead.

EISS has had several claims from members in the 18 to 25 year old age group.

[5] Exposure Draft *Treasury Laws Amendment (Protecting Superannuation) Bill 2018,* at Schedule 2, Part 1;
[6] Exposure Draft Bill, at note 5, at Schedule 2, Part 1.
[7] Draft Exposure Explanatory Materials, at note 3, at page 11.

1.4.1 TPD Claim – lifelong medical support required

One member aged 22 years old at the time of claiming, suffered a spinal cord injury causing irreversible quadriplegia. The member worked as a 4th year electrician apprentice and the member's duties had involved scaling telegraph poles, substation structures and using climbing harnesses. The insurer approved the member's claim for total and permanent disablement. The member received a $345,000 insurance benefit and his superannuation account balance of just under $18,000. The member's specialist reports supporting the member's claim detail the level of care that the member would require for the rest of his life including assistance with showering, dressing, toileting, feeding, drinking, bed mobility and overnight bed positioning. These medical notes confirm that the member would be permanently dependent on a carer to assist the member throughout each day and night.

If the member had no TPD insurance cover at the time of the claim, then the member would have only received his superannuation account balance of just under $18,000. The member's ongoing medical care detailed above would be very expensive and quickly exceed the member's superannuation account balance. Without the significant insurance benefit the member received, the member's ongoing medical costs would have fallen on the public purse.

1.4.2 Death Claim – Interdependency Relationship

Another claimant had an interdependency relationship with their child to the extent that the member financially supported their parent and provided domestic support. On the death of this member, the late member's parent (the **Dependant**) applied for the late member's superannuation account balance and the late member's life insurance benefit on the basis that the Dependant was relying on income and support from their child. The Dependant established that they relied on the late member for domestic support by paying bills and assisting with household work. The Dependant also detailed how they had expected that the living arrangements between the Dependant and the late member in the same dwelling would continue for some time.

While the late member's superannuation account balance was only less than $10,000, the insurance benefit was over $300,000 and provided the ongoing financial support that the Dependant had expected from their child. Had the late member's insurance been cancelled because of the late member's age, then the insurance benefit would have been unavailable to support the Dependant and the cost of supporting the Dependant would have reverted to the taxpayer instead.

2. Increased Cost of Default Insurance

Group life insurance policies provided through superannuation operate on the basis that members pay a premium to be covered in the event that circumstances give rise to a need to lodge a claim. The pooling effect allows lower premiums to be paid and better terms to be negotiated by a superannuation fund for the benefit of all members[8]. The insurance cover obtained by a superannuation fund on a group basis is obtained at a lower cost to members given the purchasing power and bargaining position of a fund as compared with a member of the public obtaining individually underwritten life insurance cover.

EISS requests that Treasury consider whether the Insurance Proposal will achieve the key rationale of protecting against superannuation benefit erosion[9] considering EISS's industry analysis which demonstrates that the Insurance Proposal will likely have the effect of

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[8] ASIC MoneySmart website, https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/insurance-through-super, accessed 22 May 2018 supports this conclusion under "Why get life insurance through you super?" section;
[9] Draft Exposure Explanatory Materials, at note 3, at page 11;

increasing insurance premiums which would have the unintended consequence of increasing account erosion across the superannuation industry.

According to EISS's industry analysis[10] (see Appendix A), while the level of superannuation benefit erosion resulting from default insurance varies depending on members' age and salary, the overall erosion rate is approximately 6.21% (based on levels of insurance cover as at September 2017). If all affected insured superannuation members across the industry were to lose insurance by reason of the Insurance Proposal, then EISS's analysis indicates that average erosion of superannuation benefits would fall to 5.84% if there was no resulting impact on insurance premiums as a result of the changes.

However, EISS's industry analysis indicates that there is likely to be a substantial increase in the insurance premiums paid by other members who remain in the pool of insured superannuation members. This predicted increase will be caused by younger, lower risk insured members exiting the insurance pool because of the Insurance Proposal which will change the overall shape of Australia's superannuation insurance pool and increase the risk of the resulting insurance pool.

EISS's analysis suggests that the impact of removing superannuation members from the insurance pool, because of the Insurance Proposal, would likely increase the average insurance premiums paid in superannuation by approximately 26%.

If the expected insurance premiums were to increase by approximately 26%, then it is estimated that this would cause a consequential increase in the level of overall benefit erosion from the current position of 6.21% (detailed above) to approximately 7%.

3. Re-entry into the insurance market

EISS requests that Treasury consider the impact on a member whose insurance is cancelled pursuant to the Insurance Proposal who then intends to reapply for insurance cover at a later date.

EISS considers that the Insurance Proposal creates a risk for members who do not elect to opt back into their default insurance cover that they may not be able or eligible to obtain cover on the same or better terms at a later date. For instance, as detailed above, over 60% of EISS members are employed by employers in the electricity industry and are engaged in blue collar work that predominantly involves jobs that are considered "hazardous occupations". If these EISS members elect to cancel their cover they may not be eligible for cover due to their hazardous occupation whereas these members are currently covered under EISS's group life policy.

More broadly, EISS contends that this risk would apply across the industry considering that members reapplying for insurance cover may need to meet underwriting requirements that involve an analysis of a person's health and personal circumstances that would not have been required to be disclosed to the insurer[11] under default cover that is provided automatically to superannuation fund members.

The uncertainty as to whether underwriting will be required by insurance providers for members opting back into insurance or whether cover will instead be offered with additional pre-existing conditions, as limited cover or with longer waiting periods is problematic for these members and for superannuation funds. Pursuant to the Insurance Proposal, superannuation funds are required to provide affected members with a notification that their cover will be cancelled unless they decide to opt-in. These notifications will need to provide

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[10] KPMG, Letter to EISS, at note 4, at **Appendix A**;
[11] ASIC MoneySmart website, at note 8;

sufficient detail on the risks of not only losing their insurance cover but also the risks associated with eligibility and accessing insurance at a later date, which will require some certainty as to how insurers will treat re-entry into the market.

4. Administration of the implementation of the Insurance Proposal

EISS has some concerns with the timing of the implementation of the Insurance Proposal from a fund administration perspective.

It is our understanding that the Insurance Proposal changes are stated to be effective from 1 July 2019. EISS is currently in the process of transitioning from one superannuation administration provider to another. As a result, the resources of both EISS, its incumbent administrator and the incoming administrator, are fully utilised undertaking this significant task. Therefore, additional significant administrative change of the nature included in the Insurance Proposal would significantly increase risks associated with the transition.

Further, according to EISS's analysis[12], it is expected that the administrative burden associated with turning cover on and off where members become inactive or reactivate their insurance cover will likely result in an uplift in administration costs charged by outsourced administration providers to superannuation funds.

Conclusion

EISS submits that the aims of the Insurance Proposal to protect the retirement savings of young members, members with low balances and inactive members[13] may be achieved by an alternative proposal that takes into account the consequences detailed above.

Should you have any queries regarding the contents of our submission, please contact Alex Hutchison on (02) 9046 1901 or by email alex.hutchison@eisuper.com.au.

Yours Sincerely

Alexander Hutchison
Chief Executive Officer
Energy Industries Superannuation Scheme Pty Limited

[12] KPMG, Letter to EISS, at note 4, at **Appendix A**;
[13] Australian Government, The Treasury, at note 2, at page 36;

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Our ref EISS18-InsuranceSubmission Budget-0522

Contact Adam Gee (02) 9335 7300
Wendy Tse (02) 9335 7676

24 May 2018

Dear Alex

Analysis to support EISS' submission on the proposed changes to insurance within the Federal Budget

Thank you for the opportunity to provide EISS with high-level industry analysis and commentary to support EISS' submission in relation to the proposed changes to insurance announced within the 2018 Federal Budget. As per our engagement e-mail dated 22 May 2018, we provide the following information to assist in this regard:

1. The outcomes of our modelling in relation to the impact on the erosion of member benefits of the removal of insurance for inactive members, members under age 25 and members with balances under $6,000;
2. Provision of high level insights in relation to the number of members that may be impacted by the Federal Budget changes pertaining to insurance; and
3. Confirmation of relevant industry practice in relation to the ISWG Code and the recent Federal Budget changes in relation to insurance.

Background

KPMG recognises that the proposed changes to insurance announced within the Federal Budget have been designed to legislate the outcomes suggested within the draft insurance code released late in 2017 by the Insurance and Super Working Group (the "ISWG"). The Federal Minister confirmed that she did not believe that the ISWG code went far enough and hence, there was a requirement to reduce the impact of benefit erosion resulting from default insurance within superannuation.

As a result, the Treasurer confirmed within the Federal Budget that default insurance cover would no longer be able to be provided to the following cohorts of members:

1. Members under the age of 25 ("young members");
2. Members with balances less than $6,000 ("small balances"); and
3. Members who have not made a contribution to the fund for more than 13-months ("inactive members").

Whilst KPMG is of the view that there is a need to amend the manner in which default insurance within superannuation is provided to members, we remain concerned that the removal of cover for certain segments will have a material impact on insurance for remaining members. Our analysis in relation to this is outlined below:

Erosion of member benefits

Within our report analysing the key benefits and challenges associated with default insurance within superannuation prepared for the ISWG, KPMG undertook substantial modelling in relation to the impact of default insurance on the erosion of superannuation benefits.

Whilst our analysis showed that the level of benefit erosion resulting from default insurance varies greatly depending upon individual members' age and salary, the overall erosion of a member's account balance was approximately **6.21%**, utilising levels of cover at the time of finalising our report (September 2017).

KPMG has recently updated this analysis to determine the level of benefit erosion that would result if the Federal Budget announcements were legislated and implemented by superannuation funds. Our initial analysis indicates that, where cover is removed for all members, the average erosion of benefits would fall to approximately **5.84%**, assuming there was no impact on insurance premiums as a result of the changes.

Based upon our analysis of the impact associated with removing insurance for a material number of members (particularly younger members), we believe that there is likely to be a substantial increase in the insurance premiums paid by other members. This is due to the effect that the changes would have on the overall shape and risk level of Australia's superannuation insurance pool. By effectively removing a significant number of younger, lower risk members, this has the offsetting impact of increasing the overall risk of the insurance pool, which would be borne by the remaining, older members with insurance in superannuation.

Our analysis suggests that the impact of the removal of insurance for the respective sectors of the superannuation system would be likely to increase the average insurance premium paid within superannuation by approximately **26%**. We have also modelled the impact of premium increases on the overall levels of benefit erosion, assuming different levels of premium increase. The following results are evident:

Table 1: Erosion of benefits assuming premium increase

No increase	10% increase	20% increase	30% increase
5.84%	6.42%	7.00%	7.58%

In effect therefore, where the Federal Budget changes are implemented and the expected premium increases of 20% are passed on by insurers and superannuation funds as a result of the additional risk within the group life pool, KPMG estimates that the level of benefit erosion will actually increase from the current position of **6.21%** to **7.00%**. This is primarily due to members paying higher premiums post age 25 for their insurance cover.

Membership impacts of the Federal Budget announcements

KPMG have also undertaken some initial modelling in relation to the number of members that are likely to lose cover as a result of the changes announced within the Federal Budget. KPMG have utilised the same sample set as that utilised within our ISWG report to arrive at these conclusions.

Based upon our analysis, the following percentage of superannuation members are likely to have cover removed as a result of the Federal Budget:

Table 2: Impact of changes on number of insured members

Member segment	Percentage of members losing cover
Young members	18.0%
Inactive members	45.1%
Small balances	46.2%

On the basis that there remains a material amount of overlap between young members, small accounts and inactive members, it is difficult to predict the exact percentage of members that are likely to lose cover as a result of the Federal Budget announcements, however, our estimates suggest that this could be in excess of 30% of members across the industry.

Whilst we note that the actual percentage of members that will lose cover subsequent to the Federal Budget changes will depend on a fund's underlying demographics, the impact can be significant, particularly where a fund has a large younger member base, low average account balance or high inactive member ratio.

Based on our analysis of a number of funds across the industry, it is evident that some funds will be more heavily impacted than others by the Federal Budget announcements in relation to default insurance within superannuation. Specifically, we are aware of one fund for which it is likely that approximately 83% of members could lose cover should the Federal Budget changes be implemented. Conversely, we note that another fund that is materially less impacted, with fewer than 15% of members likely to lose default insurance coverage.

Based upon this analysis and our estimates of the number of members that could lose cover as a result of the Federal Budget announcements, we remain concerned that these will have a material impact on insurance within superannuation and the number of members that will no longer maintain insurance cover.

Industry practice in relation to the ISWG Code and Federal Budget changes

Based upon KPMG's discussions with superannuation funds and the almost wholesale adoption of the ISWG code, we believe that this code, in spite of it not being mandatory, would have achieved a better balance for default insurance within superannuation.

We note that many funds have indicated that they would have found it difficult to meet the proposed 1% of salary cap on insurance premiums highlighted within the ISWG code, particularly those funds with members employed in higher risk occupations. As a result, a number were considering ways in which to justify the continuation of cover for these members, despite the level of premium exceeding the 1% of salary premium cap.

As noted above, discussions with funds and our analysis has indicated that the impact of the Federal Budget changes will have material, potentially unforseen, consequences for insurance within superannuation. In particular, the impact of the removal of members from the insurance pool on those who continue to have default insurance within superannuation post the Federal Budget changes is likely to result in them paying substantially more for their insurance.

In addition to this, funds have indicated that the expected administrative burden associated within turning cover on and off where members become inactive or reactivate accounts is also likely to result in an uplift in administration costs charged by outsourced providers.

Furthermore, there remains some risk in relation to potential greater anti-selection with respect to insurance being opt-in and the impact that this may have on the overall insurance pool. This places further emphasis on the manner in which insurers will allow cover to be activated and whether underwriting will be required to opt into cover or whether such members may be offered cover but with certain exclusions, such as pre-existing conditions or longer waiting periods.

KPMG recognises that this will add further complexity to the manner in which insurance is offered within superannuation and the way in which insurance is administered by superannuation funds going forward.

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We trust that the above information provides you with sufficient information to assist with the drafting of EISS' submission in relation to the proposed changes to default insurance in superannuation announced within the Federal Budget.

Feel free to contact me on (02) 9335 7300 or Wendy Tse on (02) 9335 7676 should you have any questions in relation to our analysis.

Yours sincerely

Adam Gee
Partner

Disclaimer

Inherent Limitations

This report has been prepared as outlined in the Statement of Work dated 22 May 2018. The services provided in connection with this engagement are comprised of an advisory engagement, which is not subject to assurance or other standards issued by the Australian Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed.

The Findings / Recommendations in this report are based on a qualitative review and the reported results reflect a perception of EISS but only to the extent of the materials surveyed and the information provided by EISS.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, EISS' management and personnel / stakeholders consulted as part of the process.

KPMG has indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within the report.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

The Findings / Recommendations in this report have been formed on the above basis.

Third Party Reliance

This report is solely for the purpose as set out in the Statement of Work dated 22 May 2018, and is not to be used for any other purpose or distributed to any other party without KPMG's prior written consent.

This report has been prepared at the request of EISS in accordance with the KPMG terms and conditions. Other than our responsibility to EISS, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party's sole responsibility.