

15 July 2019

The Committee Secretariat
Senate Standing Committees on Economics
By Email: economics.sen@aph.gov.au

Dear Sir or Madam,

**RE: Treasury Laws Amendment (Putting Members' Interests First) Bill
Submission**

Berrill & Watson Lawyers is a consumer law firm practising exclusively in the areas of superannuation, insurance and financial services law.

We endorse the submission of the Consumer Action Law Centre (CALC).

In particular, we agree with the removal of default insurance cover for members under 25 years of age but not for active superannuation accounts with balances below \$6,000, and that the implementation dates for the removal of default insurance cover should be pushed back.

General Policy Setting

Insurance in superannuation operates to "top up" the retirement incomes of superannuation fund members whose working lives are cut short because of disability or death. It is designed to provide a disabled worker with an adequate retirement income or financial support to dependents of a worker who dies prematurely.

Whilst the insurance may not completely fill the gap, it reduces welfare dependence.

However, insurance in superannuation comes at a cost to the accounts of superannuation fund members through premium deductions.

For decades, the product provided death and Total and Permanent Disability (TPD) insurance benefits at modest wholesale rates (typically \$2 per week) on an automatic acceptance basis (without health testing), although claims experience was somewhat suppressed by a lack of member engagement.

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The status changed in the 2000's when successive adverse claims experiences by most insurers led to higher premiums and reduced benefits. This attracted the attention of successive enquiries including the Productivity Commission.

The Productivity Commission in its third report Superannuation: Assessing Efficiency and Competitiveness in December 2018 found that default insurance in superannuation is good value for many members, but not all. In particular, they noted that members with low incomes and intermittent workforce participation suffered excessive account erosion when not working and having contributions made to their funds.

For this reason, the Productivity Commission recommended the adoption of what was then the Protecting Your Superannuation Bill (the PYS Bill) measures to remove default insurance cover for under 25 and inactive accounts (Recommendation 15). Importantly, they did not recommend the removal of default cover for small active accounts.

We strongly support the general policy setting of the Treasury Laws Amendment (Putting Members' Interests First) Bill (the Members' Bill) and the PYS Bill to enhance members' retirement savings by reducing the number of multiple accounts, reuniting members with inactive accounts and better targeting insurance in superannuation.

We support the measures in the PYS Bill to switch off insurance in inactive accounts, cap administration fees at 3%, ban exit fees and consolidate inactive accounts.

These measures will deal with many of the problems identified in the Explanatory Memorandum (EM) to the Members' Bill regarding unnecessary account erosion. The benefits should begin to show in the second half of 2019 and strengthen thereafter, although accurate measurements of their success will probably take at least 1 to 2 years.

Members Under 25 Years Old

We agree that death insurance cover is poorly targeted for superannuation fund members under 25 years of age. Most will not have dependents (whether a spouse, children or financial dependents) and the low mortality rate for under 25's as compared with other age groups results in disproportionate cross-subsidisation in insurance premiums.

Some funds deal with the latter by negotiating contracts with reduced benefits for older age groups and stepped premiums, but this does not usually fully reflect the proportionate risk.

The same problems do not apply to disability insurance benefits and there may be a case for maintaining the default insurance benefits for those in dangerous occupations (as was originally proposed by the Government in relation to the PYS Bill when it was being debated in parliament) or physically demanding jobs (as was proposed by the Labor opposition at that time).

However, there would be a complexity in any such carveout in the categorisation of occupations and premium allocations.

In the circumstances we support the removal of default cover for under 25's, perhaps with the Australian Prudential Regulation Authority (APRA) having the power to grant an exemption in exceptional circumstances not inconsistent with the intent of the Members' Bill to prevent unnecessary account erosion.

Members with Low Balance Accounts

Small inactive accounts have been dealt with by the PYS Bill, which removes default insurance cover for accounts that have been inactive for 16 months. However, the Members' Bill seeks to expand this to exclude all low balance accounts from default insurance cover.

The principle justification in the EM is that low balance accounts are particularly vulnerable to erosion by fees and charges (paragraph 2.19) and insurance premiums (paragraph 2.20).

The EM points out that "the current regulatory settings did not differentiate the charging of fees as a factor of account balance" (paragraph 2.30). It also asserts that the same applies to insurance premiums meaning that both are "highly regressive" in their impact on low balance accounts which are reliant on compulsory contributions for growth as opposed to investment returns (paragraph 2.5).

As the EM points out, the 3% fee cap and the exit fee ban introduced in the PYS Bill would significantly reduce the erosion of low balance account administration fees and help members grow their retirement savings (paragraph 2.63). The law now caps administration fees on low balance accounts at a maximum of \$180 or less, a reduction of 50% or more on average pre-1 July administration fees. This is a game-changer.

However, the EM also asserts that to address the alleged regressive effect of insurance premiums on low balance accounts, which are dependent on contributions for growth, default cover must be removed.

With respect, this analysis is only partially correct. Whilst the rate of group insurance premiums is not linked to account size, they are often tied to age and gender, with cheaper premiums routinely charged to younger members and younger women. This ameliorates the regressive effect of premiums on low balance accounts.

Further, the EM fails to acknowledge the progressive effect of an insurance payment on a low balance account as opposed to a higher balance account e.g. a \$200,000 TPD payout added to a \$5,000 account balance has proportionately a much greater impact than a \$200,000 TPD payout on a \$500,000 account balance.

Insurance premiums are drawn from the accounts of superannuation fund members as a whole for the benefit of the vulnerable few who suffer adverse

events. However, we submit that the assertion that this operates regressively for members with low balance accounts is overstated. Much of the regression is to be found in administration fees, which is largely dealt with in measures in the PYS Bill.

The EM acknowledges that fewer people will receive insurance payouts (paragraph 2.48) and also that those with low balances tend to be low income earners, women and seasonal workers (paragraph 2.17).

To that list, we would add:

- indigenous Australians
- new migrants
- people with disabilities and
- workers in industries with problematic employer compliance with superannuation obligations and the gig economy

The effect of the amendment would be that such vulnerable members would lose valuable insurance cover for upwards of two years or more, depending on the level and regularity of their income.

People from such cohorts work disproportionately in physically demanding or high-risk occupations and their only opportunity to obtain affordable insurance cover would be through group insurance in superannuation. If they are locked out of default cover for a significant period of time, they would be exposed to the risk of disability or death without any insurance to top up their meagre account balances and thereby they (or their dependents) would almost certainly be reliant on Centrelink income support.

It is trite to say that disability can strike at any time, including in the first 1 to 2 years of membership of a superannuation fund. We submit it is not sound policy to exclude new members from cover, particularly after the introduction of administration fee caps and the other measures in both Bills.

It is submitted that the appropriate course of action would be to defer the question of default insurance in active small accounts pending a review of the impact of the measures in the PYS Bill and the removal of default cover for those members under 25 years old, to be conducted by the Productivity Commission or ASIC

Commencement Dates

We submit that the dates by which trustees must identify members with accounts under \$6,000 (1 July 2019), notify those members of their option to have or maintain insurance cover (1 August 2019) and turn off the cover (1 October 2019) should be deferred to allow for:

- the passage of the Members' Bill and Royal Assent
- the identification of all relevant members
- the notification of those members
- time to make reasonable attempts to locate members whose addresses they did not have or who may not have received the notifications

- reasonable time to put in place documentation and communication strategies to properly communicate with members, as required by the Members' Bill
- reasonable time for trustees to negotiate new group contracts or amendments to existing contracts with their existing insurance partners or to go to market to negotiate alternative contracts at competitive prices.

There were significant problems with implementing the communication requirements of the PYS Bill, both in the short timelines and in contacting members whose current addresses were unknown, were overseas, live remotely, where itinerant or simply did not receive or understand the letters.

There are valuable lessons to be learned from this experience and the timelines in the Members' Bill run the risk of simply repeating what was a poor process to effectively communicate to members their insurance options. Ideally, a review should be conducted of that process to ensure the same mistakes are not repeated.

Elections in Writing

The Members' Bill specifies that an election by a member to maintain or to be provided insurance cover must be in writing (see Section 68 AAB (2) and AAC (2)). Part 2, Sections 8(3) and (6), specify that a notice to a member must set out the method by which a member can make an election in writing.

However, the EM appears to contradict this by stating that an election need not be in writing but may include communication by telephone or at a meeting (paragraph 1.38).

The same uncertainty was reflected in the communications following the PYS Bill, with some members told they could only make an election in writing whilst others made elections orally. There was also confusion around the format of a written election with some funds insisting that a written election must be in the format provided, whilst others allowed any written notification.

For some members, oral communication was their only realistic or preferred means of communication and some could not access, complete and return the prescribed forms before the 1 July 2019 deadline.

In addition, there was wide discrepancies in the quality of the written notifications to members with some funds criticised for providing notices which were unclear and some inappropriately encouraging members to opt-in for insurance cover.

Given the above problems with the communication regarding the PYS Bill, we submit that a standard form notice could be developed as a regulation to the Members' Bill or by ASIC as a template for funds to use to ensure that members are properly advised of the effect of the Members' Bill and their election option.

The Members' Bill should also be amended to reflect the extended means of communicating an election set out in the EM.

If you have any questions in relation to the above, please contact [REDACTED]
[REDACTED]

Yours sincerely,

A black rectangular box redacting the signature of John Berrill.

John Berrill
Principal
Berrill & Watson Lawyers