

30 July 2018

The Senate
Economics Legislation Committee
Parliament House
Canberra ACT 2600

By email: Economics.Sen@aph.gov.au

Inquiry into the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018

Rice Warner has been asked to provide the following information:

- Premium increase estimates and our supporting methodology.
- Claim numbers for members under age 25 by claim type and cause.
- An explanation of the differences between Rice Warner's estimate for additional social security costs from Treasury estimates.

Please find this information below and in the attached documents.

Premium increase estimates

We attach a copy of our report on premium impacts of the *Protecting Your Superannuation Package* legislation.

Claim numbers for under 25s

Rice Warner has estimated the number of claims and claim causes for under 25s across death, TPD and IP insurance for the year ending 30 June 2017. This has been done on the basis of the average percentage of claims attributable between 2000 and 2013¹. We have used APRA's *Annual Superannuation Bulletin's* total number of claims for each insurance type for the year ending 30 June 2017.

The average percentage of total claims and number of total claims can be seen in Table 1

Table 1. Claims figures

Claim reason	Under 25 (%)	Total claims
Death	7.9	18,170
TPD	1.8	23,155
IP	3.6	29,189

¹ Rice Warner's *Group Insurance Experience Study 2015*.

Table 2 shows the estimated splits of death claims by cause for under 25s.

Table 2. Death claim cause – under 25s

Claim reason	Death claims	TPD claims	IP claims
Cancer	115	27	96
Diseases of the nervous system and sense organs	31	34	59
Accidents, poisonings and violence (external causes)	650	85	113
Congenital anomalies	1	0	3
Death	0	0	0
Diseases of pregnancy and childbirth	2	0	0
Diseases of the blood and blood forming organs	47	11	1
Diseases of the Digestive System	10	7	21
Diseases of the circulatory system	386	7	21
Diseases of the genito-urinary system	0	1	0
Diseases of the respiratory system	52	0	27
Diseases of the skin and subcutaneous tissue	2	2	7
Endocrine, nutritional and metabolic disease	6	2	7
Infective and parasitic diseases	15	3	12
Mental disorders	3	75	147
Musculoskeletal system and connective tissue	117	158	546
Senility and ill defined conditions	1	0	1
Suicide	1	0	0
Total	1,439	412	1,061

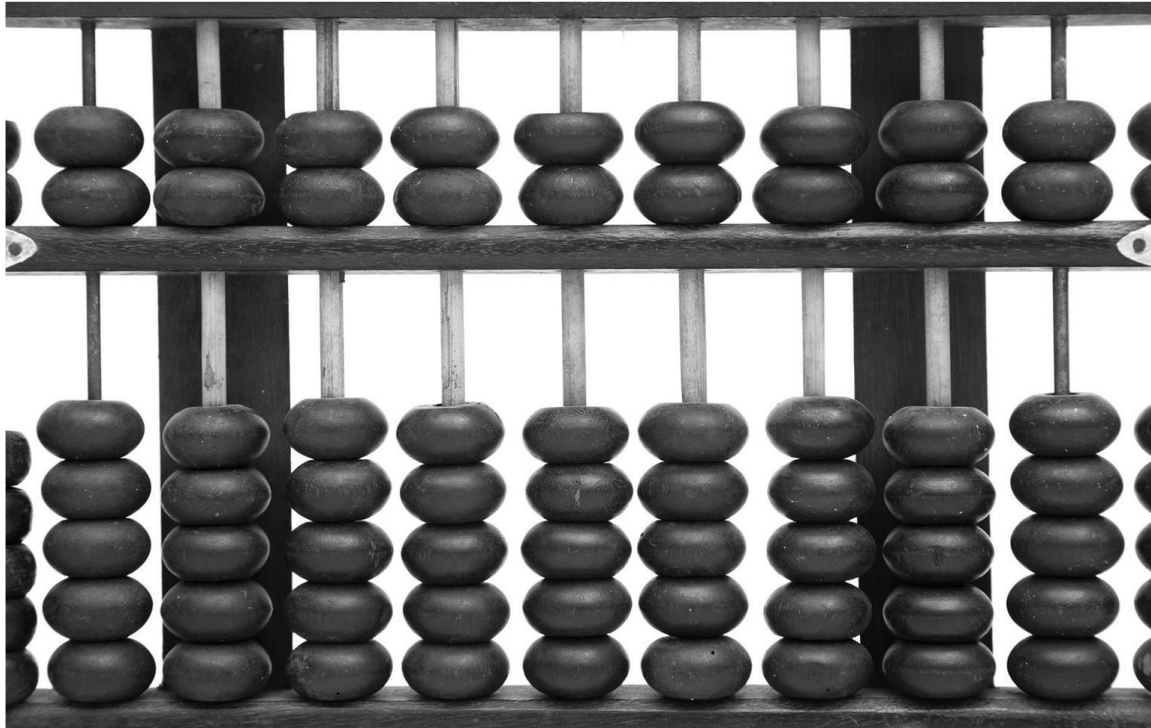
Rice Warner's estimation of social security payments

We are unaware of how Treasury has estimated the impact on social security. The appendix of our Economic Impact of 2018 Federal Budget Proposed Insurance Changes report contained information on our data sources and key assumptions.

Yours sincerely

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Federal Budget Impact – Insurance



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Disclaimer

This report has been prepared following a study of group insurance premiums in Australia.

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1. Summary of Federal Budget impact on premium rates

The 2018/2019 Federal Budget issued in May 2018 proposed some significant changes to insurance cover within superannuation as part of its *Protecting Your Superannuation Package*. As a result of the changes, a large proportion of superannuation fund members are expected to lose their insurance cover from 1 July 2019, when cover becomes opt-in for young members, those with low balances and inactive members.

A further implication is that opt-out premium rates will increase for the majority of members who retain cover. The increase in premium rates will vary considerably from fund to fund, depending on the benefit design, demographics of the membership and changes to terms and conditions to deal with switching cover on and off. Our estimates of the average industry changes to premium rates for are set out in Table 1.

Table 1. Estimated average opt-out premium increases, due to Federal Budget

	Premium increase (%)
Death and TPD	7.4
IP	20.4
Overall impact	11.1

This report sets out the methodology, assumptions and further details of our analysis.

2. Introduction

The 2018/2019 Federal Budget issued in May 2018 proposed some significant changes to insurance cover within superannuation as part of its *Protecting Your Superannuation Package*. As set out in the *Protecting Your Superannuation Package* legislation, from 1 July 2019 the trustee will be required to ensure that opt-out insurance benefits are not being provided to Choice or MySuper members where:

- their account has been inactive for more than 13 months
- their account balance has not reached \$6,000 on or after 1 April 2019
- they join the fund on or after 1 July 2019 and are below the age of 25.

Further, where a member has not made the appropriate to election, post 8 May 2018 to retain cover, opt-in cover will not be provided.

Rice Warner supports the objectives of this package which reduce the erosion of superannuation for many younger members and for those with low balances or multiple accounts. Rice Warner, while supporting these changes, does believe that default premiums will increase for death, Total and Permanent Disability (TPD) and Income Protection (IP) due to various factors, in particular the change in the demographic basis of the insured superannuation membership.

It is important to recognise that the increases will be not be uniform across the market but dependent on the:

- extent of any cross-subsidisation of existing premium rates across the fund's membership
- proportion of insured members who are currently inactive
- proportion of insured members with balances under \$6,000
- proportion of insured membership under age 25
- current rules for retention of insurance for inactive accounts, particularly for IP
- approach put in place to deal with 'opt-in'
- demographics of members who subsequently chose to opt-in.

The following report estimates the expected average premium increases across the market.

3. Methodologies and data sources

A selection of 28 funds across the three main superannuation fund sectors was analysed with the aim of gaining a reasonable representation of the overall market. Of the 28 funds selected, seven were retail funds, four public sector funds and seventeen industry funds. Funds were selected based on the size of their membership and MySuper basis, to ensure a large percentage of the market (over 80%) was accounted for in the analysis.

Rice Warner utilised the below internal and publicly available data sources in its analysis for the following purposes:

- APRA Annual Fund-level Superannuation Statistics and APRA Annual/Quarterly MySuper Statistics (June 2017) were used to determine fund specific demographic data such as the number of insured default members in each age band along with the number of inactive accounts.
- The *Superannuation Market Projections 2017 Report* is Rice Warner's analysis of the size and composition of the superannuation industry and projects forward assets and membership for the next 15 years. These projections were used to estimate the number of members across each age, gender and account status.
- Rice Warner's *Group Experience Study 2015* investigated many aspects of group life and IP claims such as incidence rates, claim development patterns, IP termination rates and claim causes. This research was used to estimate the risk premium rate by age and gender and to determine the level of cross-subsidisation of rates across age and gender.
- Rice Warner's *Group Comparator* was used to provide each fund's default premium rates and terms and conditions e.g. for switching cover on and off.
- Rice Warner's *Super Insights* is a database with over 10 million anonymous accumulation and pension accounts. This database helped to determine the interdependence amongst account status, age and account balance.

3.1.1 Assumptions

- For death and TPD cover, inactive and active members are assumed to claim at the same incidence rates.
- For IP cover it is assumed that a proportion of inactive members will not be able to receive a benefit, either because they do not have an income or because their benefit will be offset.
- Insurer administration costs for Industry and Retail funds will increase premium rates by 3% to allow for spreading fixed costs over a smaller premium base. A lower 1.5% increase in premiums due to administration expenses has been assumed for public sector funds as the impact of Federal Budget changes on membership is expected to be less than other sectors in the market (as demonstrated in Table 2).
- Every fund will adjust its terms and conditions so that the opt-in members (voluntary) and the opt-out members (default) have the same risk of claim.
- All members who currently hold voluntary cover will make an election to retain this cover.
- Loss ratios will remain unchanged.
- Analysis was based on the members aged 18 to 60 due to the relatively small insured membership aged below 18 and over 60. The membership distribution by age band is provided in the Table 2.

Table 2. Current membership distribution

	18-24	25-34	35-44	45-54	55-60	All Age
	(%)					
Industry	17	32	24	19	8	100
Retail	15	37	25	17	6	100
Public sector	5	25	28	28	14	100
Overall	16	32	24	20	8	100

4. Cross subsidy across ages for death and TPD covers

Table 3 shows the percentage of actual premium to the true risk based premium across each age bracket for different sectors in the market. Table 3 shows that cross subsidisation of premium rates across ages is still a common practice across the industry, however, the degree of cross subsidisation within each fund varies significantly. Table 3 shows that members between ages 18 to 25 are, on average, paying three times their true premium. In general Industry funds have the largest degree of cross subsidisation across ages.

After Federal Budget changes have been implemented, the option to cross subsidise will be reduced as younger members will be removed from the insured basis. Ultimately, this will increase premiums for the remaining insured members.

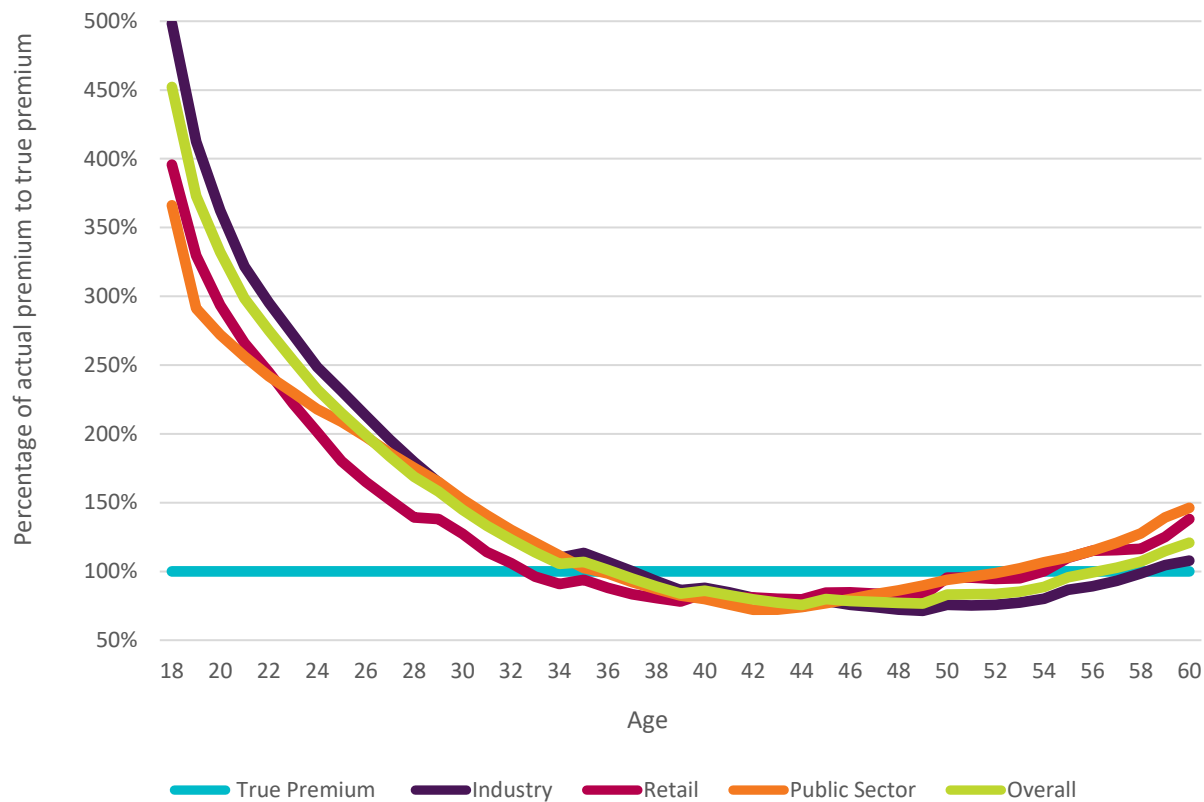
Table 3. Percentage of actual premium to true premium for death and TPD cover

The Ratio	18-25	26-35	36-45	46-55	56-60	All Age
	(%)					
Industry	330	151	87	76	99	100
Retail	267	122	82	92	122	100
Public sector	261	148	81	95	130	100
Overall	304	144	85	83	109	100

Graph 1 shows the level of cross subsidisation at each age against the true premium. As expected, members between ages 35 to 55 are paying premiums that are lower than their true premiums. This would predominately be due to these members having the highest insurance needs and sums insured which would be expensive without cross subsidisation.

It should be noted that while members aged less than age 35 are paying more than their true premium, the size of the true premium is quite small and therefore a small absolute dollar increase corresponds to a large percentage rate increase.

Graph 1. Percentage of actual premium to true premium for death and TPD cover



5. Reduced membership

Table 4 shows the estimated reduction in default (opt-out) insured membership for each sector, once all members aged under 25 are no longer eligible for opt-out cover. Current insured members under age 25 will maintain opt out cover if they are active and have a balance of at least \$6,000. Members who are not eligible for opt out cover may choose to opt in to cover, although based on Rice Warner's experience in working with funds and insurers, no more than 10% of members currently do so.

Table 4. Percentage of membership losing default (opt-out) cover

	18-24	25-34	35-44	45-54	55-60	All Age
	(%)					
Industry	100	45	42	37	34	51
Retail	100	51	44	39	37	54
Public sector	100	26	23	21	21	27
Overall	100	45	40	35	32	49

Public sector funds are the least impacted by the Federal Budget changes as these fund's members are less likely to be inactive, have low balance or be young compared to retail and industry sector members. Retail sector funds are the most impacted due to the relatively large proportion of low balance members.

When comparing the level of cross subsidisation against the reduction in membership, it can be seen that the ages where cross subsidisation is the highest corresponds to the highest percentage of members losing default cover. Therefore, an increase in premium would be expected for all sectors. Public sector would be impacted the least due to the lower number of members losing default cover.

6. Estimated average premium rate increase for death and TPD cover

Table 5 shows a summary of the estimated premium increases for death and TPD cover due to the proposed Federal Budget changes.

Table 5. Summary of the estimated average premium rates increases for death and TPD covers

Sector	Death		TPD		Overall
	Male	Female	Male	Female	
	(%)				
Industry	6.8	7.3	10.7	10.4	8.8
Retail	8.7	7.0	4.8	5.0	6.4
Public sector	2.7	3.2	3.7	3.8	3.4
Overall	6.6	6.6	8.3	8.1	7.4

All sectors show an increase in premiums for both benefit types and genders. We estimate that overall there will be a 7.4% increase in premium rates with a 6.6% increase in death rates and 8.2% increase in TPD rates¹. The Industry Fund sector is estimated to have the biggest premium rates increase of 8.8% since it has the highest combination of the degree of cross subsidisation and impacted membership demographics. Public sector funds have the smallest estimated increase of 3.4% because it has the lowest level of inactive, young or low balance members and a relatively low level of cross subsidy.

¹ TPD premium rates are taken to be the difference between death and TPD rates and death only rates.

7. Estimated average premium rate increase for IP cover

IP premium rates are expected to be impacted differently than death and TPD rates. IP cover is further complicated due to variable monthly benefits and various types of waiting period and benefit period offered. Fewer funds offers default IP cover (only around a quarter) and for some funds opt-out cover starts at a later age than opt-out death and TPD cover. In addition, it is more common for funds to cease offering opt-out default IP cover if the account balance is lower than \$6,000 or contributions cease to be paid for a period. This means that the impact of the Federal Budget on IP premiums will be very low for some funds.

Our analysis of the market demonstrated that the total default (opt-out) IP premium is dominated by a handful of funds. We therefore focussed our analysis on these few funds. The same approach was used for determining the IP premium increase as for death and TPD. The result is that default IP premium rates are expected to increase by 20.4%. We have not shown any further detail due to the small number of funds analysed.

As is expected that many inactive members paying for IP default cover can never actually receive IP benefits, the premium previously collected from inactive members has been assumed to be totally born by the remaining members. This has a major impact for those funds which currently continue cover for inactive members.

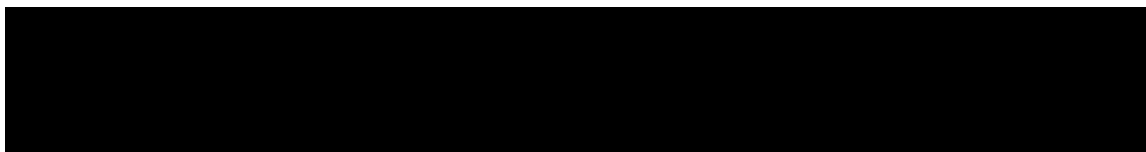
8. Overall impact of the Federal Budget on premium rates

Whilst the expected average IP premium increase of 20.4% is higher than the expected death and TPD average premium increase of 7.4%, default IP premium makes up a lower proportion of the total default premium received for all types of default cover. Based on our analysis above and the total premiums in the market, we expected that the overall impact of the Federal Budget changes on opt-out premium rates would be an increase of 11.1%.

This report was prepared and peer reviewed by the following consultants.

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31 July 2018