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9 July 2018

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Via email: economics.sen@aph.gov.au

Re: AIA Australia submission on the Federal government's proposed 'Protecting Your Super Package'

AIA Australia (AIAA) welcomes the opportunity to work with the Federal Government in addressing the unnecessary erosion of superannuation balances and to share our submission outlining our position on the proposed reforms.

AIAA is Australia's largest group insurer and in 2017 paid out more than $1 billion to group insurance members on more than 15,000 claims. We are committed to a group insurance system which supports a growing number of Australians each year – a system that also works because it benefits everyone and delivers protections for all.

We are concerned that the Federal Government has not adequately considered the serious and unintended consequences of their current package. Our primary concerns relate to the removal of cover for those under 25, and for working Australians with low balance but active superannuation accounts, along with the unrealistic timeframe being given to the industry to implement any such reforms.

In addition to our submission, we refer the Committee to RiceWarner's '*Economic Impact of 2018 Federal Budget Proposed Insurance Changes',* and KPMG's '*Insurance in Superannuation: The impacts and unintended consequences of the proposed Federal Budget changes'*. These analyses highlight that there will be only minimal improvements in retirement balance savings for members, and in many cases members will be worse off. The KPMG report found that the adoption of the proposed reforms would lead to a 26 per cent rise in premiums for remaining insured members and would leave them worse off at retirement with their balance to be eroded by a further 1.2 per cent.

This is an unacceptable outcome even before we consider the impact of millions of Australians being without financial and health protections in the event of a serious injury, illness or death.

The Federal Government should not remove appropriate levels of protection or coverage for active, working Australians, nor should they distinguish between active members due to age or account balances, as these individuals have risks and insurance needs as with other member cohorts. Instead, they should focus on new measures for inactive accounts. The Productivity Commission's recent *'Superannuation: Assessing Efficiency and Competitiveness'* report labelled duplicate accounts as a core driver of balance erosion with an estimated cost of excess insurance premiums for members being $1.9 billion each year. By adopting new measures on inactive accounts, the government would achieve two-thirds of its cost saving target and address the important issue of duplicate accounts.

Should you require any further information, please do not hesitate to contact me or Jeremy Houghton, Head of Strategy & Corporate Affairs, on [redacted] or at [redacted]

Yours sincerely,

[redacted]

Damien Mu
Chief Executive Officer
AIA Australia and New Zealand

Attachment 1 - *AIA Australia submission outlining the unintended consequences of the Federal Government's 'Protecting Your Super Package'*

Attachment 2 – *RiceWarner 'Economic Impact of 2018 Federal Budget Proposed Insurance Changes'*

Attachment 1

AIA Australia submission outlining the unintended consequences of the Federal Government's 'Protecting Your Super Package'

Response to: Protecting Your Super reforms
Response from: Jeremy Houghton, Head of Strategy & Corporate Affairs
AIA Australia (ABN 79 004 937 861 AFSL 230043)
Issue date: May 29 2018
AIA AUSTRALIA LIMITED

WE'RE FOR LIFE

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Executive Summary

AIA Australia (AIAA) supports the Government's intention to protect superannuation balances from inappropriate erosion via its 'Protecting Your Super' package, and recognises the need for reforms to improve the system and deliver the right balance of appropriate protections to suit all member needs.

Insurance is a key feature of the superannuation system which is relied upon by a significant number of members and their families each year, guarding against the risk that an individual may be impacted by an unfortunate event or injury where they are unable to continue building a superannuation balance.

It is AIAA's view that the Government has not appropriately assessed the serious and unintended consequences of these reforms, which will significantly disadvantage vulnerable individuals in society, in particular young Australians under 25 and those with low balance active superannuation accounts.

The Government's package – announced in the 2018/19 Budget – proposes that superannuation funds offer insurance on an opt-in basis in relation to accounts:

- that have balances below $6,000;
- of new members who are under 25 years old; or
- that have not received a contribution for 13 months or longer.

In the recent Productivity Commission draft report *'Superannuation: Assessing Efficiency and Competitiveness'*, it was noted that the most significant financial gains for members will come through the removal of duplicate accounts, which it describes as 'by far the most egregious driver' of balance erosion and estimates that the annual cost is $1.9 billion of excess premiums for members.

AIAA welcomes reforms that support the removal of duplicate accounts and believes this can be achieved through the Government's proposed opt-in model for inactive members, where a contribution has not been received in 13 months or longer. By adopting this measure, which is broadly consistent with the Insurance in Superannuation Working Group Voluntary Code of Practice, the Government can achieve two thirds of its targeted costs savings and address the primary concerns of duplicate accounts.

However, the proposed changes have not adequately considered the unintended and serious consequences of removing cover for those under 25, nor the impact of low balance active superannuation accounts. While the Government has prioritised further cost savings in these measures, this submission highlights that the financial gains will be minimal for the majority of young members, and a financial drain on the economy. The reforms do not represent good value for money, nor will minor gains in personal savings offset the benefits of being protected via the important safety net of life insurance in superannuation.

Summary of findings

The basis of AIAA's concerns in relation to the proposed reforms are summarised as follows:

1) They **do not address the erosion of superannuation balances** and will not have a material impact on an individual's retirement balance. The likely benefit is just 0.27 per cent or $1,400 over the course of an individual's working life due to increased premiums for remaining insured members[1].

2) The reforms will **cost the Government and Australian economy $2.46 billion** annually. The Government will also only **experience marginal tax revenue gains** of just $29.9 million each year.

3) AIAA protects more than **750,000 members with active but low balance superannuation accounts**, which represents a quarter of all AIAA group policy holders. **These members have insurance needs**, with more than $75 million in claims paid in 2017.

4) There are **major sustainability risks**, with premiums for remaining insured members to increase by up to 15 per cent as a result of the demographics of the group insurance risk pool changing and opt-in behaviours.

5) Once implemented, the reforms would **leave more than 90 per cent of young Australians under 25 without cover**, with the 'opt-in' rate potentially as low as 2 per cent. This represents around 1.4 million young people under 25 being without much needed financial protections[2].

6) Young Australians are **less likely to opt-in due to over optimism about their risk**, **and apathy** – 40 per cent of young members are unaware what their superannuation balance is, let alone being in a position to consider their specific insurance needs and take active steps to opt-in.

7) **Australians rely on the safety net of group insurance**, with claims and benefit payments growing year on year. AIAA has paid $84 million on 1200 claims for people under 25 since 2015.

8) **More than 585,000 people under 25 work on a full time-basis[3]**, representing 40 per cent of the entire under 25 working population. 45 per cent of these full-time workers are in blue collar jobs.

9) Workers in **casual employment or high-risk jobs** such as the mining and construction industries may be **unable to attain life insurance, particularly for disability**.

10) The changes could result in **almost half of Australia's entire group insurance member population being without life insurance**, representing a potential 7 million people.

11) It would represent **a backward step in supporting individuals with a mental health disorder**, with mental health claims the largest claim cause of Total and Permanent Disability (TPD) for under 25s and the third largest for Income Protection (IP).

12) The **welfare system isn't equipped to support individuals at the same level** as life insurance, with Youth Allowance payments at 18 per cent of the national average wage and Disability Support Pension only 34.5 per cent. IP claimants receive up to 75 per cent or more of their pre-disability income.

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[1] Based on a projected average account of $528,300 based on today's dollars
[2] ABS Census 2016
[3] ABS Census 2016

Fundamentals of Insurance in Superannuation

Group insurance benefits everyone in society because it delivers protections for all. The system works by distributing risk across a pool of known members to form a 'community rating' within a fund, allowing for lower premiums, limited or no underwriting, broader coverage and fewer administration fees. This collective response to risk benefits all Australians and can only be achieved on an opt-out basis.

Group insurance was specifically designed in this way to be efficient and offer wide-ranging benefits to members, as well as the Government and broader economy by way of reduced social security benefits and increased spending capacity for members and their families. Within this, the default opt-out model provides all members with access to insurance, which results in a robust payoff at the wider societal level via a cross subsidisation of risk across large groups of individuals via their group schemes.

This system has delivered significant value for Australians. AIAA paid more than $1 billion in claims to group insurance members on more than 15,000 claims in 2017. The industry paid $6.4bn in claims to insurance in superannuation members in 2016/17[4].

Safety net of group insurance

Life insurance is a core element of superannuation, which provides an important safety net for individuals who are least likely to consider their insurance needs, including young people. By design, it provides cover to exactly those individuals who would either not opt in to or be unable to attain insurance cover at all, or on reasonable terms.

For a significant number of members each year, they or their dependents need to call on life insurance in superannuation much earlier than expected and for a longer period of time due to a death, illness or disability. In these events, life insurance is paramount to ensure an individual's needs are met.

The default system currently provides coverage to almost 70 per cent of individuals with death and TPD cover[5]; while, more broadly, the default opt-out group insurance system supports more than 95 per cent of working Australians with life insurance[6]. The benefits of coverage are significant and have been articulated in research by Rice Warner as[7]:

> *"Within group schemes, there is a large affinity to occupation; for many individuals, group insurance is their only means of viable access to insurance (especially for individuals with risky occupations). In the absence of group life insurance (for example if group life insurance were to become opt-in in nature, and take up rates dropped to an expectedly low single-digit rate), many individual's only recourse would be to seek retail type insurance, individually rated insurance with medical, financial and lifestyle underwriting required, which would act to reduce their access to insurance or make it only available at unaffordable premium rates."*

In essence, through the distribution of risk across a pool of members, group insurance ensures that all individuals and groups in society are able to access the benefits and protections of life insurance. The default model does not discriminate against any member cohorts, such as individuals working in heavy blue collar or high risk occupations, nor against workers who would not qualify for life insurance in normal circumstances, or be unable to acquire cover on acceptable terms.

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4 APRA Annual Superannuation Bulletin June 2017
5 Rice Warner – Insurance in Superannuation, 2016
6 Rice Warner: Economic Impact of 2018 Federal Budget Proposed Insurance Changes, 2018
7 Rice Warner: Underinsurance in Australia, 2017

The benefits of group insurance

Members receive substantial value through group insurance, with 81 cents in every dollar collected in premiums paid back through claims to the member[8]. By design, this value is often delivered through benefits payments to a minority in society, at a small cost for the majority. This is reflected in that the average benefit paid to an individual by AIAA is $136,721 for death and TPD and $23,257 for IP, while premiums are priced on as little as $2.65 per week.

In considering the purpose of group insurance, it's important that its value isn't primarily assessed upon the ongoing and regular benefits received by an individual. The value of group insurance should not – and never should be – determined this way. The value of group insurance is in providing an invaluable safety net for all working Australians.

Unexpected life events do happen, and they happen at any age. When they do, group insurance provides the necessary protections to help mitigate against the often devastating and potentially life-changing impacts of a serious illness, injury or disability.

To demonstrate this, the rate of group insurance benefits paid at AIAA in 2017 was as follows:

- 2.5 death and TPD benefits per 1,000 members with death and TPD cover
- 6.3 IP benefits per 1,000 members with IP cover

AIAA considers there to be numerous other benefits to the group insurance system, believing that:

- It is more efficient and reliable than self-insurance (such as personal savings) as this is rarely sufficient to support individuals and families over an extended period of time. This is particularly true for young people and individuals with low balances.
- It delivers greater value relative to other forms of life insurance due to low acquisition costs.
- It represents good value for money: 81 cents in every dollar is returned to the member
- It reduces the cost to Government – removing the default insurance in super system in its entirety would result in a cost to Government and the broader economy of more than $17 billion.[9]
- It provides financial protections during a working life, with an average of 2-6 people per 1,000 needing support each year of their working lives; and a comfortably funded retirement provided through superannuation savings are interwoven elements of a sound financial plan.
- It is more cost effective given that auto-enrolment allows for lower cost administration.

[8] APRA Statistics Summary 2011 to 2016
[9] Rice Warner: Impacts of Removing Insurance from Superannuation, 2017

The need for insurance and our experience across different cohorts

Young Australians under 25 rely on life insurance

AIAA considers any policy decision based on the underlying notion that young Australians don't require the protections offered by life insurance as being ill-conceived. Young Australians do rely on life insurance and the absence of these protections would increase the health and financial risks of individuals under 25 should their working life be cut short by an unfortunate event.

AIAA also rejects the notion that life insurance should be removed for young people given that they are casual or part-time workers, with 40 per cent of workers under 25 doing so on a full-time basis. This equates to 585,000 full-time workers under 25[10]. Of those working full-time, 45 per cent also work in high-risk or blue collar industries such as mining and construction[11].

In removing the default model for under 25s, the Government would be removing a much needed safeguard for young Australians, who without these protections face the prospect of having limited financial protections in place to deal with a serious injury or illness. The financial impact of this would depend upon a number of factors, including their level of debt, number of dependents, age and number of children, and other insurance products held.

Beyond those members who are married, have dependents or have a mortgage – the broader population of young people under 25 still have insurance needs, particularly for disability; and for these young Australians, their most valuable asset is their future earning potential. This is what life insurance protects and is reflected in the below analysis of AIAA's claims experience:

- AIAA paid $84 million on 1200 claims for people under 25 since 2015. This grows year on year.
- Rates of IP and TPD claims at AIAA are approximately the same for people aged 20 and those aged 30. This is also reflected industry-wide.
- Mental illness is the largest claim cause at AIAA for permanent disability for members up to 25.

In considering the value of insurance, the Government must also recognise that debt levels – and the ability to repay debt in the event of an unforeseen event – is also a growing issue for young Australians, who will be exposed further without the necessary protections that come with a group insurance policy.

Figures published by the Australian Bureau of Statistics highlights the prevalence of an increasing dependence of debt among young people[12].

- Of Australians under 25, one in four have debt worth 75 percent or more of their assets. The median debt to asset ratio is 0.40, which is the highest of the age bands.
- 14.6 per cent have debt three or more times their income. The median debt to income ratio is 0.34.
- Over 20 per cent of those aged under 30 have a mortgage.

[10] ABS Census 2016
[11] ABS Census 2016
[12] ABS: Household Income and Wealth, Australia, 2015-16

The consequence of this debt as a result of an unforeseen life event is that the outstanding balance becomes the responsibility of a family member or dependant. It should be noted that 40 per cent of people aged under 30 are married or have dependants, refuting suggestions that all death benefits are paid to parents. One super fund reported to the Insurance in Super Working group (ISWG) that 70 per cent of death benefits paid for members aged from 21-25 were paid to a spouse or dependant. This emphasises the differences in the needs of members between funds, reinforcing why trustees are best placed to determine the insurance design for their members.

Low opt-in rates for young Australians

AIAA modelling indicates that young Australians would be less likely to actively opt-in to life insurance due to over optimism about their risk, and apathy – 40 per cent of young members are unaware what their superannuation balance is, let alone being in a position to consider their specific insurance needs and take active steps to opt-in. The rationale behind these behaviours is well defined. When considering risk many people – and, in particular young people – have a mentality of "it will never happen to me". For others, the nature of life insurance can be quite confronting and unpleasant to consider. As a result, many would rather avoid considering the risk altogether, let alone take active steps to insure against it.

This is particularly concerning when you consider that young Australians are the least likely to consider their insurance needs, despite being less financially secure and having fewer accumulated funds in superannuation to support in the event of a serious illness or disability.

In an opt-in model, each trustee will determine the degree of risk it wants to protect its members from when accepting opt-in requests, which may include some form of underwriting that will likely exclude or limit the coverage offered to various member cohorts, such as:

- Hazardous and heavy manual occupations including construction, or those in high-risk industries such as mining
- Individuals with existing health issues that may prevent them from working in the future. These individuals would be unable to receive cover or have pre-existing conditions excluded.
- Casual workers and short-term contactors, who would likely be excluded or have limitations on the type of cover they may be granted (i.e. death only, but no coverage for disability).

This issue needs to be more appropriately addressed by Government, as we know that 40 per cent of under 25s work on a full-time basis; and of those, 45 per cent work in high-risk or blue collar occupations[13]. For these individuals, their largest asset is their future income.

AIAA estimates that less than 10 per cent of young people are likely to opt in under the revised Government model, with opt-in rates potentially as low as 2 per cent even with extensive industry marketing campaigns.

This low rate of opt-in would reflect the inherent attitude of young people towards life insurance, where individuals undervalue the need to protect their income and their life, as outlined below:

- People with multiple health risk factors perceive themselves to be in good health, with 46 per cent of people with more than four risk factors still believing they are in good or very good health[14]

[13] ABS Census 2016
[14] Australia's Healthiest Workplace Survey by AIA Vitality 2017

- Forty per cent of people would feel the impact of losing the primary income earners salary within a month; yet still, half of working age Australians said if not included automatically in their super that they would not have cover[15]

Despite these views, there are 786,000 people who were unable to work due to ill health, injury or disability and received income support from a government or private source in FY2015/16.[16] A further 6.5 million Australians accessed sick leave entitlements in the same period.[17]

At the same time, society is grappling with the increasing rates of mental ill health, with one in five Australians experiencing mental ill health every year, and half experiencing a mental health disorder in their lifetime[18]

Low balance but active superannuation accounts

AIAA recognises and supports the fundamental need to protect members from the erosion of their superannuation balances as a result of multiple accounts. This was highlighted by the Productivity Commission as the largest driver of balance erosion at a $1.9 billion annual cost to members.[19] The Government should address this need through their proposed opt-in model for inactive accounts, which is broadly in line with the Insurance in Superannuation Voluntary Code of Practice, achieving two thirds of their targeted cost savings.

They should not attempt to realise financial gains through removing the important safety net of life insurance for members with an active account, regardless of age or account balance. The central purpose of life insurance in superannuation is to protect individuals from unforeseen events by guarding against risk of a serious injury, illness or disability. By definition, an active account member is a working member of society making regular contributions, meaning they have insurance needs.

Given these needs, the Government should not remove appropriate levels of protection or coverage for active, working Australians. They should not discriminate against active members due to age or account balance, as these individuals face the same risks and insurance needs as other member cohorts.

For example, the rates of IP and TPD claims are approximately the same for people aged 20 and those aged 30, both at AIAA and industry-wide.

Our experience also shows that members of active and inactive accounts claim at a similar rates. This shows that at an individual's time of need, there is still the utilisation of benefits that a member may have previously been aware of or apathetic to, regardless of activity or member contributions.

An unintended consequence not yet considered by the Government under the current proposal is the gap in insuring low balance but active members prior to reaching the $6,000 threshold. While an inactive member with a low balance is at risk of serious erosion, an active member would be contributing to their account. Incoming measures in the Insurance in Super Voluntary Code of Practice, where the cost of cover cannot exceeds 1 per cent of estimated earnings, will mitigate erosion issues for contributing members.

[15] AIA Life Today Study 2016
[16] The Cross Sector Project: Mapping Australian Systems of Income Support for People with Health-Related Work Incapacity
[17] The Cross Sector Project: Mapping Australian Systems of Income Support for People with Health-Related Work Incapacity
[18] Australian Bureau of Statistics: National Survey of Mental Health and Wellbeing, 2009
[19] Productivity Commission: Superannuation - Assessing Efficiency and Competitiveness, 2018

For an average full-time working Australian with total earnings of $81,500, it would take 11 months to accumulate sufficient contributions in a new account to meet the $6,000 threshold. For the average working Australian with total earnings of just under $62,000, it would take almost 15 months to accumulate this amount. This is a significant period where the majority of new members will be exposed without adequate protection[20].

Case studies

The four case studies below demonstrate the value and benefits of life insurance in superannuation.[21]

Case study 1 – new member with balance below $6k

Nancy had just started her first full-time job after graduating from University as a mechanical engineer. At 22, Nancy was diagnosed with ovarian cancer, only two weeks after starting her first career role. In Nancy's case, the diagnosis was early and a combination of chemotherapy and surgery was recommended and the prognosis was good. However she was told to expect to be off work for more than 12 months as she recovered.

Nancy was automatically covered by her super fund from the day she commenced employment. This meant that she was eligible to receive a income protection benefit in excess of $5,500 each month to help her cover some of the treatment costs and maintain her lifestyle. As Nancy recovers, she has also taken advantage of AIA's CaRe™ program – aimed at helping those recovering for cancer get back to wellness and prepare them for re-entry into the workforce. Nancy remains off work, but wants to get back into her old job really soon and has started discussing a gradual return to work.

Under the proposed changes to insurance in super, Nancy would not have accumulated $6,000 in her account for at least 6 months and would not have received cover automatically. In Nancy's case, her cover may have commenced when she reached this balance but this would have been after her diagnosis and commencing treatment.

Case study 2 – young member suffering from mental health issues

Kelly worked as a hairdresser, with plans of owning her own studio in the near future. Since leaving school her focus was on being the best at what she enjoyed. Kelly has suffered recurring depressive episodes since the age of 18, but had generally been able to manage these, while still working. At 23, the severity of her mental health condition took its toll and she was unable to continue to work, despite her employer being very tolerant.

As the illness was not work related, she had to rely on her income protection cover that was provided automatically by her employers default super fund. In addition to the financial support – more than $45,000 so far, towards replacing her lost income – Kelly was motivated to return to work. She was supported by AIA's RESTORE™ program, which helps to overcome the barriers for those suffering mental health in return to the workforce. Kelly has started a gradual return to work program, but continues to receive financial support from her income protection cover as well as regular check in's with her rehabilitation consultant.

[20] ABS- average weekly earnings November 2017. This allows for contributions tax but ignores fees and investment earnings.
[21] Case studies represent real-life examples of AIAA members. Names and other personal or identifying details have been either removed or adapted for privacy reasons.

Under the proposed changes to insurance in super, Kelly would not have been entitled to automatic insurance unless she had elected to opt-in. Many younger people have low levels of financial literacy and engagement, and it is likely that Kelly would not have opted-in for cover. She would have been reliant on social security to provide her with some income and would not have received tailored rehabilitation and return to work support.

Case study 3 – young member suffering terminal illness, married with dependants

Brandon always wanted to do something with his hands, doing an apprenticeship in tool making straight from school. Unlike some of his mates who went to university, Brandon was earning an income from his late teens. Brandon and Jane married at 20 and wanted to start a family straight away. They were also lucky to be able to buy a 2 bedroom unit close to work to get their first step on the property ladder. Jane gave birth to twins when Brandon had just turned 23 – a late birthday present.

Brandon was diagnosed with a malignant melanoma – skin cancer - when the twins were just 6 months old. Unfortunately for Brandon and his young family the diagnosis was terminal and he was certified as having less than 24 months life expectancy. Surgery and other treatment simply wasn't an option.

Brandon didn't know where to start, but contacted his super fund to see how he could get access to his superannuation. He was told that in additional to the $20,000 in his account he also had life insurance cover, with a payment of $168,000 for terminal illness.

While the financial payment could never replace Brandon, it did provide some financial support for Jane and the twins in preparing for the end. Part of the superannuation payment was used to reduce the mortgage and give Jane some time to get back on her feet. It also allowed Brandon to go on one last surfing trip with his mates to Bali.

Under the proposed changes to insurance in super, Brandon would not have been entitled to automatic insurance unless he had elected to opt-in. Many younger people have low levels of financial literacy and engagement, and it is likely that Brandon would not have opted-in for cover.

Case study 4 – heavy manual worker who suffered a serious accident and claimed TPD

Mal always wanted to find the right work – life balance. More life than work was always his approach. Finishing work for the weekend and getting out on his mountain bike with his girlfriend and his mates was what made the week bearable.

Mal worked as a construction rigger, having worked in construction since leaving school. While suffering a few scrapes and minor injuries at work, that resulted in some workers compensation support - he always wanted to keep active.

Just before his 25th birthday, Mal was seriously injured while mountain bike riding. It was a momentary loss of attention but it had lifelong implications. Mal suffered serious spinal injuries resulting in paraplegia and would never be able to return to work. A wheelchair was his next destination.

Mal was fortunate that he listened to his dad (sometimes). His dad encouraged him to take an interest in his super and the need to consider life insurance – just in case something happened. Mal was able to claim his TPD cover, resulting in a payment of over $180,000. Not enough to replace the income and lifestyle he had lost – but did allow him some freedom in modifying the family home to cater for the wheelchair.

Under the proposed changes to insurance in super, Mal would not have received life insurance automatically, instead he would have been required to opt in. In Mal's case, it's likely his dad would have encouraged him to take up that option. However, what isn't clear is what hurdles Mal may have faced in being able to opt-in. Working in a heavy manual occupation, with recent time off work for workplace injuries, could have prevented Mal from getting any cover for disability at all, or may have imposed limitations on that cover. Despite the best endeavours of Mal's dad to make sure that his young son was protected – Mal would have to satisfy some hurdles to obtain cover and those hurdles would likely be higher for someone working in his field.

The impact of the proposed budget measures

Financial comparisons of removing default life insurance for under 25s

Core to the Government's proposed reforms to remove default life insurance for under 25s is the unnecessary erosion of superannuation balances for young Australians. AIAA supports this intent and the need for members to have more funds in retirement, however new research commissioned by AIAA and completed by Rice Warner highlights that the reforms will fail to have a material impact on an individual's retirement balance.

To demonstrate this, AIAA has assessed the impact of an individual's retirement balance based on three potential scenarios in Table 3:[22]

Table 3. Impact of Budgetary changes on individuals retirement balance

Scenario	Balance at retirement (today's dollars)	Percentage improvement from current
Current arrangements	528,300	-
Premiums start from age 25, premiums increased by 15%	529,700	0.27
Premiums start at age 25, no changes to premium rates	532,300	0.76

The research demonstrates that the benefits of removing default life insurance for under 25s would be minimal. In the instance of premiums commencing from age 25, and factoring in an estimated premium increase for remaining members of up to 15 per cent, the average improvement in retirement balances would be just 0.27 per cent or $1,400 over the course of an individual's working life.

In the unlikely event of premiums remaining flat, average retirement balances are still only expected to improve by a marginal amount of 0.76 per cent in comparison to current arrangements.

It is false to assume that young Australians don't require insurance and this data raises legitimate questions as to the value of such reforms, where under 25s will forgo the valuable protections afforded under the safety net of group insurance for minimal financial gains in retirement. Further supporting the research is that rates of IP and TPD claims at AIAA are approximately the same for people aged 20 and those aged 30, a percentage of claims that is reflected industry-wide.

Impact on Government and the economy of removing default life insurance

The research also demonstrates that the collective impact of the proposed reforms would come at an annual cost of **$2.46 billion** to the Government and Australian economy[23]. AIAA considers that this research, outlined in Table 4, raises concerns as to the financial merits for such reforms.

[22] Rice Warner: Economic Impact of 2018 Federal Budget Proposed Insurance Changes, 2018
[23] Rice Warner: Economic Impact of 2018 Federal Budget Proposed Insurance Changes, 2018

Table 4. Additional annual cost to Government and the economy

Annual cost of proposed Federal Budget changes to insurance in superannuation	($ million p.a.)
Lost tax due to reduced insurance claim payments	(277.0)
Lost spending capacity due to reduced insurance claim payments	(2,493.0)
Increased social security spending due to reduced insurance claim payments	(185.7)
Total Lost	**(2,955.7)**
Gained tax due to reduced contribution tax concessions	451.9
Gained tax due to reduced earnings tax concessions	40.7
Total Gained	**492.6**
Total	**(2,463.1)**

In assessing the isolated tax implications of the proposed reforms, the research indicates that Government will benefit from a marginal gain of $29.9 million in taxation revenue each year. AIAA does not consider this gain in taxation revenue to be sufficient in offsetting the potentially devastating social impacts of removing the important safety net of default life insurance for under 25s.

Increased social security payments and reliance on welfare system

While governments are under increasing pressure to meet growing social security and healthcare demands, insurance in superannuation is a private sector solution minimising taxpayer costs when an individual suffers a serious injury or illness, transferring risk from the public purse to the insurer.

The removal of default life insurance will transfer this risk back to Government through the welfare system, meaning that individuals would be forced to rely exclusively on family, community and the social security system for financial support.

A reliance on social security will results in an individual's quality of life being substantially reduced, with this support generally not being sufficient to maintain a pre-disability lifestyle. For example, Youth Allowance payments are only 18 per cent of the national average wage and Disability Support Pension is only 34.5 per cent.

On the other hand, IP claimants can receive 75 per cent or more of their pre-disability income, while the average claim by AIAA for death and TPD is $136,721. For those members under the age of 25 years, AIAA continues to pay more than 150 claimants each month, paying an average of $227,000 each month, or $2.7 million per annum. Over the past few years, AIAA has paid in excess of 500 IP claims of the 1,200 total claims paid to those under 25 years.

The consequence of removing default insurance is that members who previously relied on claim payments will now turn to Government for financial support. Table 5 outlines the impact of this and the increased financial costs for Government to support across a death, TPD or IP benefit[24].

Table 5. Annual social security cost of removal/reduction of implementing budget changes to insurance

Segment	Total Impact / Increase ($m)	Difference vs. current amount)
Budget impact on death cover	13.0	24.3%
Budget impact on TPD cover	50.5	10.1%
Budget impact on IP cover	122.2	17.7%
Total Budgetary impact	185.7	

In addition to the financial ramifications and lower levels of protections, a reliance on the Government through social security would also result in fewer Australians being covered in the event of a serious or unexpected life event. The research highlights the proportion of people with cover as follows[25]:

- **Death** – 94 per cent of people currently with cover / 54 per cent post-Budget changes
- **TPD** –81 per cent of people currently with cover / 47 per cent post-Budget changes
- **IP** – 33 per cent of people currently with cover / 19 per cent post-Budget changes

Industry sustainability

There are major sustainability risks to implementing the reforms as currently proposed and, without further consideration, these measures would have a destablising effect on the industry.

As a minimum, AIAA proposes that the Government needs to reconsider the timing of the proposed change, since this would force insurers to reprice their group insurance policies well before the deadline of 1 July, 2019 to allow super funds time to make system changes and communicate with members. Without this readjustment, insurers would potentially suffer significant financial losses, as expected claims will exceed premiums collected.

There are three main concerns in relation to the deadline. The first is that repricing policies will have long lead-times. It will not be possible for AIAA and many other insurers to review and reprice all group insurance arrangements in this timeframe given resourcing and capacity constraints. In some cases, there may be an inability to complete this contractually, until the expiry of current premium rate guarantees, as such a scenario as proposed by the Budget announcements would never have been contemplated in previous agreements.

The second is the challenge for insurers to appropriately reprice premiums. This would lead to insurers being forced to predict the behaviours and opt-in preferences of members, which would leave the sector

[24] Rice Warner: Economic Impact of 2018 Federal Budget Proposed Insurance Changes, 2018
[25] Rice Warner: Economic Impact of 2018 Federal Budget Proposed Insurance Changes, 2018

exposed in setting premiums. The uncertainty around an insurer's ability to reprice, or how to price for member behaviour, could lead to significant under or over-pricing, which is not sustainable or equitable.

The third impact of the short implementation timeframes is the need for funds to undertake significant communications activities to drive member engagement and meet appropriate disclosure obligations. The current timetables pose significant hurdles for trustees and insurers that will lead to administration issues, errors and member detriment, which likely would manifest itself in increased disputes and potentially litigation.

In any case, a reduction of insurance for young Australians would increase premiums for remaining members, as removing under 25s would change the demographics of the risk pool and the underlying principle of group insurance through the distribution of risk.

Our modelling suggests that the removal of cover for members under 25 would contribute to an increase in premiums payable for remaining insured members by up to 15 per cent to compensate for the increase in the average age of insured lives. This would reflect the increased risk for insurers, including the unpredictable nature of member opt-in behaviour, which would lead to more claims given those who opt-in or retain cover are more likely to claim. This will increase the cost for remaining pool members.

AIAA also estimates that, based on previous experiences, opt-in members will be at least twice as likely to claim as members who are provide cover on an opt-out basis. This represents a distortion or inefficiency in the system, where the member pool can become unsustainable.

In a worst case scenario, this risk of instability to the system could lead to insurers and reinsurers exiting the market, reducing competition and driving up cost. The industry has demonstrated this behaviour before, with insurers and reinsurers existing the market in 2012 – 2015 because of sustainability issues.

There are also other non-financial risks to industry sustainability and the support and benefits life insurers provide to members. If a member does not have access to IP benefits, it will mean that they lose not just financial support but additional support services across areas such as occupational rehabilitation. These wellness programs that previously supported a member in their recovery and return to health will now be their responsibility and have to be sourced by the individual themselves. This is not a good outcome for the individual, and will have broader social and economic impacts as a result.

Unintended consequences and the implications for Government

Life insurance becomes unattainable for casual workers and high-risk occupations

The Government's proposed changes could lead to many young Australians working in casual employment or high-risk jobs such as the mining and construction industries being unable to attain life insurance, particularly for disability, removing an important and necessary safety net.

This is because group insurance schemes were designed to accommodate a broad spectrum of risk across the nation's policy holders, and a change to the default model would leave these members exposed where there is some form of underwriting.

Leaves young Australians exposed and without cover

AIAA modelling indicates that the decision to remove the important safety-net of group insurance would leave at least 90 per cent - and most likely up to 98 per cent - of young Australians without cover. This puts these individuals at an extremely high risk should they need to support themselves in the event of a serious injury or illness, particularly where they are forced to leave the workforce prematurely and require long-term financial assistance.

This is concerning as most young people are less likely to be able to self-fund in the event of a serious and unexpected event given that, for many, their largest asset is their future income. These individuals and their dependents may then be forced to rely on family, community and the social security system.

In particular, removing the important safety-net of group insurance for younger Australians puts those individuals with a young family, raising children or paying a mortgage at a higher risk. Without insurance, many individuals and families may need to sell their homes or move to rental properties that are lower cost – resulting in children changing schools, and loss of social circles when people most need support.

Equally, there is a significant risk in moving to an opt-in model for active contributing members, which goes beyond the core need for the industry to address balance erosion as a result of duplicate accounts. The Government should not reduce cover for active members, nor should they determine the insurance needs of working Australians based on balance, as these individuals have the same insurance requirements as other member cohorts.

Fails to account for the rapid rise of mental health disorders

Mental ill health is becoming more prominent in society and is more common for individuals at a younger age than other claims causes. Mental ill health has grown to now represent the third largest area of all claims at AIAA, sitting behind only cancer and musculoskeletal conditions as the leading claim causes. Mental ill health is also the largest claim cause at AIAA for group insurance TPD claims for members under 25, representing one in four of all claims; and is the third largest claim cause for IP.

Removing default life insurance would be a significant backward step in supporting those with a mental health disorder, and that these individuals would find it more challenging to receive the support and financial protections they need to overcome their illness.

It should be recognised that life insurance is especially important for those impacted by mental ill health as it's much harder to establish a mental health claim under workers compensation because the condition needs to be work related. Currently, mental health makes up only 6 per cent of claims for workers' compensation, which is well below the life insurance average[26]. In some states in Australia, 65 per cent of psychological claims made as part of workers' compensation are rejected[27]. Without life insurance, these individuals would be left without financial support, which is likely to exacerbate their condition.

[26] Safe Work Australia: Work-related mental disorder profile, 2015
[27] The Cross Sector Project: Mapping Australian Systems of Income Support for People with Health-Related Work Incapacity

AIAA's proposed alternative

AIAA supports measures to remove unnecessary balance erosion

AIAA supports the intention of the Government's proposed reforms to protect superannuation balances from inappropriate erosion and is committed to working towards meaningful changes across the industry. However, to achieve meaningful change, the Government must find the right balance of appropriate protection against premium costs for members.

In considering these reforms and, in-line with supporting the intention to protect balances from unnecessary erosion, AIAA endorses the proposed opt-in model for inactive accounts where a contribution has not been received in 13 months or longer. By adopting this measure, which is broadly consistent with the Insurance in Superannuation Working Group Voluntary Code of Practice, the Government can achieve two thirds of its targeted costs savings and address the primary concerns of duplicate accounts.

Transition deadline must be extended

The Government must also consider its proposed deadline of 1 July 2019 for the implementation of any reforms. This is not a sufficient period of time to implement such fundamental changes and would likely lead to significant instability in the system. In addition to the challenge of re-pricing policies, the deadline does not allow the industry to appropriately communicate with its members to drive the right degree of member engagement. Allowing sufficient time for trustees to engage with members will increase the number of individuals who make active choices about their insurance, with higher opt-in rates meaning a more sustainable life insurance in superannuation system.

Maintain an opt-out model for young Australians under 25

The proposed changes for under 25s do not adequately consider the potential unintended consequences of removing cover for younger Australians. While these changes may deliver a marginal protection of retirement savings for those who reach retirement age, at an increased retirement balance of just 0.27 per cent, they do not consider the financial protection required for those who have their working life cut short by an unfortunate event, injury or illness.

For reasons outlined in this submission, a decision to prioritise cost savings for under 25s at the expense of the group insurance safety net will have devastating consequences for the many young people who rely on life insurance each year. The Government cannot ignore or underestimate the potentially life changing consequences associated with these individuals not being appropriately insured.

A more appropriate solution would be to streamline the type of protections offered to young Australians to ensure that products are better aligned to their needs and offered at a more affordable rate. Trustees are best place to determine the appropriate cover for their members based on demographics, needs and risk profile.

At the same time, AIAA recognises the need for superannuation fund trustees, particularly those in the default system, to engage and communicate more effectively with their younger members to ensure they understand the benefits of life insurance and the cover provided. This period of consultation with the Government on the proposed reforms is an opportunity for the industry to further consider how best to engage their younger members about all aspects of their superannuation savings, including insurance. Greater engagement will lead to better outcomes in retirement.

Maintain an opt-out model for low balance active accounts

The recently released Productivity Commission draft report has identified duplicate accounts as the primary driver of balance erosion. AIAA supports this view and is committed to an opt-in model for inactive accounts, which is broadly consistent with the Insurance in Superannuation Working Group Voluntary Code of Practice.

However, active members regardless of their balance should remain as opt-out given these are working Australians with insurance needs. Removing these individuals from a default model of insurance doesn't address inappropriate balance erosion but instead increases the risks and consequences should an individual experience an unforeseen and serious event, whether due to cancer, injury or mental ill health.

Mandate the Insurance in Superannuation Code of Conduct

The Government has publically criticised the industry for a failure to 'self-regulate' and to take necessary steps to avoid member balances from inappropriate erosion. In particular, the Government has voiced concerns in relation to the voluntary nature of the Insurance in Superannuation Voluntary Code of Practice.

AIAA acknowledges the Government's concern around the enforceability of the Code, but maintains that changes to default insurance can still be better addressed through this mechanism. The Code was designed to address the concerns of balance erosion in a far more nuanced way through product design principles, premium caps and appropriate automatic cessation provisions that protect balances and maintain broad coverage. It was specifically developed this way to avoid the serious unintended consequences that would apply under the Government's proposed reforms.

If the Government's concern is around the enforceability of the Code, it could have solved the legislative barriers that existed, rather than implementing broad brush solutions to complex challenges, in particular changes to group insurance for under 25s and low balance active superannuation accounts.

Attachment 2

Economic Impact of 2018 Federal Budget Proposed Insurance Changes

29 May 2018

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1. Executive summary

1.1 About this report

In May 2018 the Australian Federal Government handed down a fiscal Budget that proposed significant adjustments to the default insurance provided through Australia's superannuation system. Under the proposed changes, superannuation funds will be unable to provide opt out cover from 1 July 2019 to:

- any member that has been inactive for more than 13 months
- all new members below the age of 25
- members with balances below $6,000.

While variable on a fund-by-fund basis, Rice Warner data suggests that implementation of these changes will reduce the sums insured through superannuation by 47.5%. This report sets out Rice Warner's estimate of the financial impacts of these changes to the government, the economy and the individuals impacted by proposed changes.

1.2 Impact on Government and economy of removing default life insurance

In the event of a death, Total and Permanent Disability (TPD) or Income Protection (IP) benefit claim, the after-tax amount is available to meet the needs of the individual and/or their beneficiaries. Thus, these benefit payments provide a source of taxation revenue and support economic productivity through:

- taxation revenue charged on claim payments
- taxation revenue generated on the interest earned on claim payments
- increased spending where a claim provides a family with additional income
- social security payments made to those in need.

In the event that the proposed changes are implemented, these effects will be reduced. Table 1 outlines the estimated magnitude of this effect and reflects that the net impact of these changes is small relative to the size of the aggregate Australian economy (GDP of $1.2 trillion in 2016).

Table 1. Additional annual cost to Government and the economy

	Annual cost of proposed Federal Budget changes to insurance in superannuation ($ million p.a.)
Lost tax due to reduced insurance claim payments	277.0
Lost spending capacity due to reduced insurance claim payments	2,493.0
Increased social security spending due to reduced insurance claim payments	185.7
Less: Gained tax due to reduced contribution tax concessions	451.9
Less: Gained tax due to reduced earnings tax concessions	40.7
Total	**2,463.1**

1.3 Impact on individuals of removing default life insurance

Despite the small aggregate impact on the wider economy, a lack of insurance in the event of death or disablement can have a serious impact on individuals and their dependants. In many instances, the default insured benefits provided through superannuation far outweigh the benefits available through social security. While the impact on individuals is difficult to quantify due to the vast range of individual circumstances, it is expected that young families with limited personal assets will be at greatest risk due to the changes.

In contrast, for the majority of individuals who do not make a claim over their working life, removal of default life insurance will result in improved retirement outcomes. This stems from the reduced premium deductions from their superannuation accounts. However, as Table 2 reflects, this benefit for an average member is minor, even where the proposed changes have no impact on pricing.

Premium rates are expected to increase as a result of this change for a number of reasons. One of the key factors is that numerous subsidies may exist across various cohorts of members. For example, cross subsidies commonly occur across age, occupational class, membership categories and whether or not a member is active. A further reason is the impact of member behaviour. For example, we would expect those members who are more likely to claim to take up options to opt in or to retain cover. In addition, premium rates will increase because insurers provide some fixed costs services which will need to be spread across a smaller insured membership base.

The membership profile, insurance design and level of premium cross-subsidy differ from fund to fund, therefore premium increases are expected to differ considerably across the market. AIA has estimated average premium increases of 15%. When this level of premium increase is taken into account for the remaining insured members, average retirement balances are only expected to improve by 0.27% as a result of the change.

Table 2. Impact of Budgetary changes on individual's retirement balance

Scenario	Balance at retirement (today's dollars)	Percentage improvement from current
Current arrangements	528,300	-
Premiums start from age 25, premiums increased for the remaining insured members by 15%	529,700	0.27
Premiums start at age 25, no changes to premium rates for the remaining insured members	532,300	0.76

1.4 Conclusions

Insurance in superannuation provides an important safety net for Australian households who would otherwise suffer financial hardship in the event of the death or disablement. The proposed changes will have a significantly negative impact for a small proportion of families who would have otherwise claimed. For the majority of members who do not claim, they will offer a marginal improvement in retirement balances. The aggregate economic effect is expected to be minor.

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

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29 May 2018

2. Background

2.1 Mandate

In May 2018 the Australian Federal Government handed down a fiscal Budget which proposed significant adjustments to Australia's superannuation system. Some of these changes focused on the ability of superannuation funds to provide default (opt-out) insurance cover to members. Given the significant nature of these changes, Rice Warner has been contracted by the AIA Australia Limited (AIA) to estimate the financial impacts to the government, the economy and the individuals impacted by proposed changes.

2.2 Summary of Budget changes

Under the proposed changes superannuation funds will be unable to provide opt-out cover from 1 July 2019 to:

- any member that has been inactive for more than 13 months
- all new members below the age of 25
- members with balances below $6,000.

If these changes are legislated, Rice Warner does not expect the average superannuant to replace their lost cover either by opting into voluntary cover offered by the fund or outside the superannuation environment. This stems from the general lack of awareness of the need for death and disability insurance and is evidenced by generally poor take up of opt in cover.

2.3 Change in insurance take-up

In estimating the impact of the proposed changes, this report considers the potential reduction in total sum insured that may follow in the Australian group (superannuation) insurance market.

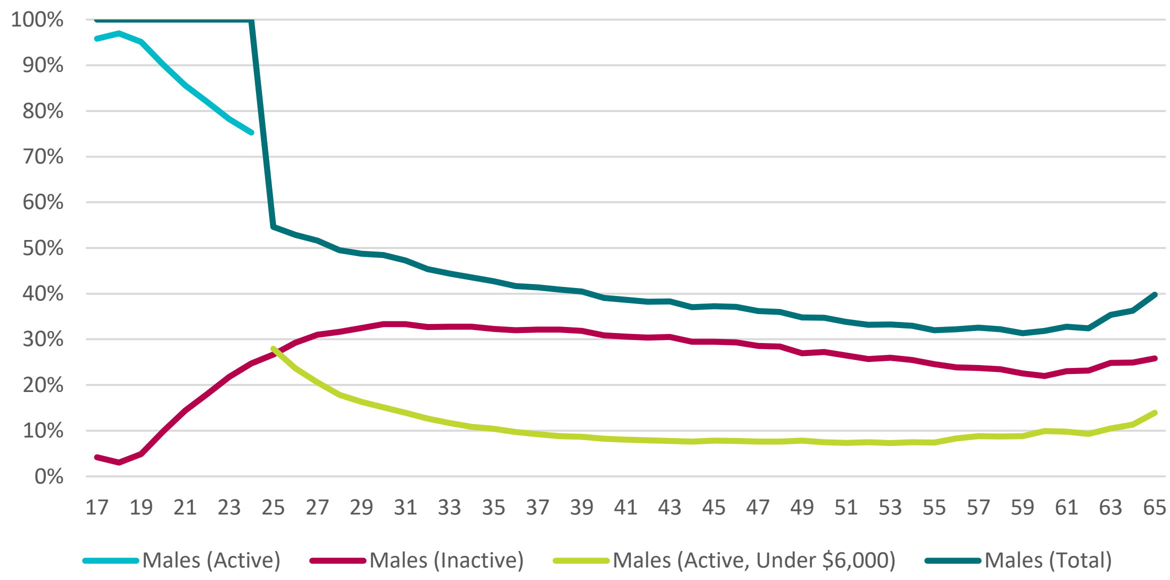
Graph 1 and Graph 2 reflect the proportion of male and female cover that is expected to be removed from each of the cohorts of members who will no longer be eligible for opt-out cover. Males and females have been considered separately. For the purpose of our analysis we have removed cover from members under age 25, although existing members will be able to keep their cover if their balance exceeds $6,000. This allows an understanding of the ultimate position when all members under 25 have no opt-out cover.

Overall, the analysis demonstrates that men and women are similarly impacted with an expected 47.5% overall reduction in cover driven by the removal of cover for:

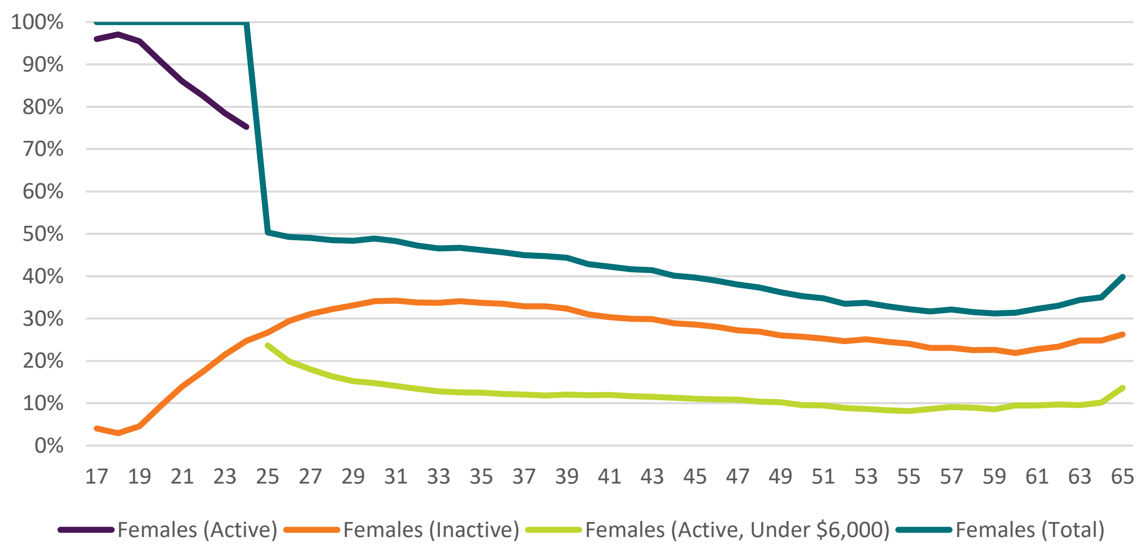
- Individuals aged below 25 who comprise a significant volume of total accounts.
- Inactive members above the age of 25 who had previously held insurance by default.

The impact of removing opt-out cover for individuals over age 25 who have a balance under $6,000 is relatively small and is expected to reduce over time as small inactive accounts are consolidated by the ATO.

Graph 1. **Proportion of members impacted by respective changes (cover-weighted), males by age**



Graph 2. **Proportion of members impacted by respective changes (cover-weighted), females by age**



2.4 Caveats to the analysis

This report has leveraged a range of key assumptions that warrant noting, including:

- Market sums insured and demographic patterns are in line with those demonstrated by Rice Warner's *Super Insights* research. While representative of a significant share of the market, this sample is weighted toward industry funds which typically, although not for all, have a young membership with low superannuation balances and a significant proportion of inactive accounts.
- Inactivity of greater than 13 months is proxied by a 12 month timeframe due to data limitations.
- Increases in group insurance premiums following the change will not give rise to a material reduction in insurance take up. This assumption has been made due to the typical disengagement of superannuants and a historical tendency to be price-insensitive to changes in fees.

Given these assumptions, the estimation of reduced cover can be considered an (accurate) upper bound for the proportion of cover that will be lost due to the proposed changes.

In addition, it is noted that the proposed changes will result in an increase in the premiums charged to the remaining insured members for a number of reasons. One of the key factors is that numerous subsidies may exist across various cohorts of members. For example, cross subsidies commonly occur across age, occupational class, membership categories and whether or not a member is active. A further reason is the impact of member behaviour. For example, we would expect those members who are more likely to claim to take up options to opt in or to retain cover. In addition, premium rates will increase because insurers provide some fixed costs services which will need to be spread across a smaller insured membership base.

While the extent of this increase is likely to vary on a fund-by-fund basis AIA has estimated an increase in the range of approximately 15%. A lower increase assumption would slightly reduce the impact on member retirement balances but would result in a higher impact on the economy.

3. Impact on Government and the Australian economy

Insurance aims to mitigate the effect of low likelihood but high impact events such as death and disablement. However, where these events occur, there are wider ranging consequences for both the Government and the domestic economy. These include:

- Changed taxation, lost economic productivity and spending capacity for the individual and their spouse, especially where household working hours are reduced to provide care for loved ones.
- Provision of social security payments to support families without or with reduced income.

Notably all the above costs are lessened where life insurance exists.

This section of the report sets out Rice Warner's estimate of the financial impacts of the proposed reduction to default life insurance within superannuation funds. This is done through placing a value on the cost to the Government and the economy of removing this insurance.

We have not included the benefits to State Government flowing from stamp duty on default insurance, estimated to average rate of 3% of premiums. We have also not attempted to place a value on the economic benefit of the *peace of mind* provided by the insurance *safety net*. When no insurance is in place, some individuals will curb their spending (and others will feel they should be curbing their spending) to increase family savings for future unforeseen events.

3.1 Reduced taxation revenue and reduced spending in the economy

3.1.1 Primary effects – tax on insurance payments and lost spending capacity

In the event of a death, TPD or IP benefit claim, the after-tax amount is available to meet the needs of the individual or their family. As a result, this benefit payment provides a source of taxation revenue and supports economic productivity. These benefits stem from:

- taxation revenue charged on claim payments
- taxation revenue generated on the interest earned on claim payments
- increased spending where a claim provides a family with additional income.

APRA fund level statistics show the level of insurance premiums deducted by funds over the financial year. Thus, this total premium amount less an adjustment for profit and expenses provides an approximation for amount payable in claims and therefore available as taxation revenue and spending.

Based on this approximation and the analysis of Section 2.3 (Changes in insurance take-up), Table 3 outlines the impact of the proposed changes reducing total cover in the market by 47.5%.

Table 3. Lost annual tax and spending capacity due to removal/partial removal of default cover

	Impact of Budget changes ($ million p.a.)
Lost tax due to reduced insurance claim payments	277.0
Lost spending capacity due to reduced insurance claim payments	2,493.0

If family members cease work to provide care, the economy suffers further losses in respect of lost income and productivity. However, given the optional nature of this sacrifice and the expectation that this is more likely to occur for low income earners, this effect is assumed to be immaterial relative to the other effects considered in this report and has therefore been omitted.

3.1.2 Secondary effects – contribution tax

If cover is reduced, insurers will deduct fewer premiums from the accounts of superannuants. Thus, the volume of assets held within superannuation will increase and thereby the contributions and earnings tax collected will increase. While uncertain, this effect is expected to partially off-set the loss of direct taxes and spending associated with claim payments as:

- Contributions tax is calculated on contributions net of premiums.
- Income tax is calculated on total earnings with higher balances attracting greater interest.

Table 4 reflects the extent of these impacts in the 2019 financial year assuming a 15% increase in premiums for the remaining insured members. Notably, due to the compounding nature of earnings tax this amount is expected to increase by approximately $15 million year on year.

Table 4. Effect on contributions and earnings tax, 2019 financial year

Year	Contribution tax	Earnings tax	Combined impact
	($ millions)		
Impact	451.9	40.7	492.6

3.1.3 Total effect

Given these estimates, Table 5 summarises the effect of the proposed changes on collected taxation revenue and economic spending to reflect that:

- Lost spending capacity through reduced claim benefits paid is expected to drive the majority of the fiscal impact of the proposed changes.
- Lost tax revenue on claims is expected to be offset by the reduction in superannuation tax concessions.

Table 5. Impact of proposed Budget changes on taxation and spending capacity

	Impact ($ million p.a.)
Lost tax due to reduced insurance claim payments	277.0
Lost spending capacity due to reduced insurance claim payments*	2,493.0
Less: Reduced tax due to increased superannuation tax concessions (2018-19)	492.6

3.2 Increased social security payments

3.2.1 Basis and methodology

Social security payments are made to support individuals who are unable to support themselves. Following the removal of opt out insurance, it is expected that there will be an increase in these payments as individuals who would have previously relied on claim payments turn to the government for support.

In estimating the financial impact of these increased payments, this report considers the present value of the change in expected social security payments following the Budget changes to cover. This is calculated as sum, across the working age population, of:

- (the probability of a claim), *multiplied by*
- [the present value of (social security payments after a claim if fully insured, less social security payments if not insured) x proportion of people who do not have cover, *plus*
- the present value of (social security payments after a claim if fully insured, less social security payments after a claim based on median level of death insurance) x proportion of people who have cover.]

Notably, while the overall working age population is relatively stable, albeit increasing and aging slightly, this calculation, assuming no indexation of benefits and no discounting, gives a good estimate of the current cost to the Government of each respective type of underinsurance.

3.2.2 Death cover

Table 6 and Table 7 respectively outline the proportion of people who are assumed to have death cover and the proportion who are expected to claim (age dependent death rates) based on the *ABS Life Table 2013 to 2015.*

Based on these figures and the methodology set out in Section 3.2.1 (Basis and methodology), Table 8 sets out the expected impact on national social security following the proposed changes for death-only insurance.

Table 6. Proportion of people with death cover and median death insurance

	Current position (with default death cover)	Position post-Budget changes
	(%)	
Proportion of people who have death cover of some kind	94	54
Current median level of death insurance as a percentage of basic needs for those with cover	51	50

Table 7. Age dependent death rates

Age	Male	Female
	(%)	
People aged 20	0.0488	0.0224
People aged 30	0.0769	0.0357
People aged 40	0.1395	0.0769
People aged 50	0.2931	0.1800
People aged 60	0.6656	0.3992

Table 8. Estimated cost of social security payments due to death-only underinsurance

	Current	Budget	Difference
	($m)		($m/%)
Cost of Governmental Social Security Payments	53.7	66.7	13.0/24.3

3.2.3 TPD

Table 9 and Table 10 respectively outline the proportion of people who are assumed to have TPD cover and the proportion who are expected to claim (age dependent TPD rates) based on historical claims data[1].

Table 9. Proportion of people with TPD cover and median TPD insurance

	Current position (with default TPD cover)	Position post-Budget changes
	(%)	
Proportion of people who have TPD cover	81	47
Current median level of TPD insurance as a percentage of basic needs for those with cover	17	17

Table 10. Age dependent TPD rates

Age	Male and female
	Combined (%)
People aged 20	0.0541
People aged 30	0.0471
People aged 40	0.0812
People aged 50	0.2444
People aged 60	0.9651

[1] Data derived from a number of industry superannuation funds, adjusted to remove the estimated impact of the modest selection that occurs on acquiring insurance at the time of entering such funds.

Based on these figures and the methodology set out in Section 3.2.1 (Basis and methodology), Table 11 sets out the expected impact on national social security following the proposed changes to default TPD insurance.

Table 11. Estimated Cost of Social Security Payments due to TPD underinsurance

	Current	Budget	Difference
	($m)		($m/%)
Cost of Governmental Social Security Payments	499.6	550.1	50.5/10.1

3.2.4 IP

Table 12 and Table 13 respectively outline the proportion of people who are assumed to have IP cover and the proportion who are expected to claim based on historical data[2]. This report has assumed an average claim duration of approximately six months in line with the assumed deferred period of two weeks.

Table 12. Proportion of people with IP cover and median IP insurance

	Current position (with default IP cover)	Remove default IP cover
	(%)	
Proportion of people who have IP cover	33	19
The current average level of IP as a percentage of income for those with cover	63	62

Table 13. Age dependent IP rates

Age	Male and female Combined (%)
People aged 20	0.2951
People aged 30	0.3291
People aged 40	0.5261
People aged 50	0.9324
People aged 60	1.9347

Based on these figures and the methodology set out in Section 3.2.1 (Basis and methodology), Table 14 sets out the expected impact on national social security following the proposed changes for IP insurance.

Table 14. Estimated Cost of Social Security Payments due to IP underinsurance

	Current	Budget	Difference
	($m)		($m/%)
Cost of Governmental Social Security Payments	691.9	814.1	122.2/17.7

[2] Estimated from historical insurer data, increased by 95% to allow for population rather than insured lives morbidity, and the recent market experience of increases in disability claim rates using a 2 week waiting period.

Notably it is possible for individuals who are temporarily disabled to receive sick leave benefits from their employer beyond the first two weeks of disablement. This would in turn make them ineligible for social security payments and thereby lead to the proposed figure being slightly over-stated.

3.2.5 Net cost to the Government in social security due to Budget insurance changes

Table 15 summarises the estimated net impact of the proposed changes on Australia's social security. Overall it reflects that the net impact is small relative to the $25.5 billion allocated to payments to those with disabilities (and their carers) in the in the 2017-18 financial year[3]. This is likely due to a:

- Large number of people who are eligible for disability related social security benefits but are not eligible to claim a TPD insurance benefit.
- A large proportion of individuals having a view toward relying on strong governmental safety nets (such as the aforementioned $25.5 billion) and resulting lack of need for insurance.

Notably, the impact of changes to TPD and IP cover far outweigh those attributable to changes to death-only cover. This stems from the fact that:

- In the event of a TPD claim an insured member's family receives disability benefits in addition to additional family tax benefits, subject to means testing.
- TPD insurance has the effect of reducing social security benefits more than death cover does as:
  - Required sums insured (to meet the insurance needs) are higher for TPD than for life insurance.
  - Social security income and assets tests are stricter for disability benefits than for family tax benefits, the latter being relatively more significant upon death.
- IP benefits provide an ongoing payment. This ongoing benefit may cause means-testing rules to continuously apply to individuals rather than on a once-off basis.

Table 15. Annual social security cost of removal/reduction of implementing Budget changes to insurance

Segment	Impact ($m)
Budget impact on death cover	13.0
Budget impact on TPD cover	50.5
Budget impact on IP cover	122.2
Total Budgetary impact	**185.7**

3.2.6 Other considerations

3.2.6.1 Reduction in stamp duty revenue due to the removal of default insurance

Stamp duty is payable on life insurance premiums in Australia. The amount of stamp duty varies by state/territory and by type of cover. In some instances, it is payable on all premiums and in others it is payable on first year premium only. We have not calculated the amount of the lost stamp duty revenue to state governments from this source but the lost stamp duty revenue is less significant compared to the additional (Commonwealth Government) social security costs (see Section 3.2.5 – Net cost to the Government in social security due to Budget insurance changes) and the costs from the lost taxation and spending capacity due to reduced insurance claim payments (see Section 3.2.1 – Basis and methodology).

[3] Source: Australian Government 2017-18 Budget Paper No1.15A, Table 2.1.1.

3.2.6.2 NDIS Rollout

The Government is gradually rolling out the new National Disability Insurance Scheme (NDIS) to assist disabled members of the population with a range of support services. It will not provide income replacement and thus the families will still require financial support.

4. Impact on individuals of removing default life insurance

Following death or disablement of an individual, dependants may face a wide range of financial ramifications, including the repayment of debt and the funding of ongoing costs. While the extent of this impact will depend on numerous factors, the most significant are the:

- alternative assets which may be used to fund incurred expenses
- extent of expenses which the individual and/or their dependents face.

4.1 Alternative funding options

In the absence of an insurance benefit payment (say due to the removal of cover), personal savings and investments may assist in funding obligations. However, statistics[4] reflect that Australians typically have limited savings or investments, except for superannuation and the family home. Further, given the necessary nature of the home and the restricted access to superannuation, these assets are rarely available for use.

Under the proposed Budgetary changes, all new members aged below 25 and all members with superannuation balances below $6,000 will forgo cover unless they opt in. Importantly, it is these individuals who are least likely to have amassed personal wealth to fund expenses should death or disablement occur.

All inactive members, for whom the fund has not received contributions for 13 months will also forgo cover. Whilst many of these members will have cover in the fund receiving their superannuation guarantee contributions, other individuals may not have cover elsewhere, for example because they are on maternity leave.

4.2 Major expenses

4.2.1 Housing

Data from the 2016 Census shows that 34.5% of Australian households own a home underpinned by a mortgage while a remaining 30.9% pay rent. In the event of death or disablement, these payments need to be funded where an individual has dependents.

However, data obtained from the 4 May 2017 Speech by RBA Governor Philip Lowe suggests that a third of loans have less than one month's mortgage repayment buffer. This indicates that without insurance, many individuals/families would need to sell their home. Where a household rents, it is expected that some would also need to shift to lower cost properties in the wake of death or disablement.

4.2.2 Dependents

Rice Warner's *Underinsurance in Australia Report 2017* reports that insurance needs are greatest where a couple has multiple dependent children. While most families with dependent children are supported in part by social security benefits, the disposable income of the average young Australian family is limited. This is reflected in Rice Warner's *Underinsurance in Australia Report 2017* which references an insurance need of between $700,000 and $1,150,000 for young parents aged 30.

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[4] Survey of Income and Housing (2013-14)

4.3 Erosion of account balances

Despite the significant benefit of insurance cover where individuals claim, it is important to consider the costs of these benefits. Australian superannuants who do not make a claim due to death or disablement but retain cover throughout their working life have premiums deducted from their account balance each year. This deduction of premiums leads to a smaller amount available for the member's retirement.

Under the proposed changes, Australians who do not voluntarily elect cover will forgo premiums in the first seven years of their working life. Table 16 shows the impact of this change on a typical member's account balance[5] at retirement and shows that the change will give rise to a 0.77% increase in retirement balances if premiums do not increase as a result of the change. Given that premiums are expected to increase for the remaining insured members by approximately 15% using AIA estimates, the estimated average improvement in retirement balances post changes is only 0.27%. Considering this small improvement, it could be questioned whether the loss of cover for the impacted individuals is justified.

Table 16. Impact of Budgetary changes on individuals retirement balance

Scenario	Balance at retirement (today's dollars)	Percentage improvement from current
Current arrangements	528,300	-
Premiums start from age 25, premiums increased for the remaining insured members by 15%	529,700	0.27
Premiums start at age 25, no changes to premium rates for the remaining insured members	532,300	0.76

[5] Assuming a starting balance of $0 and annual investment returns of 5.95%.

5. Conclusions

Table 17 outlines the components and net impact of the proposed changes to insurance in superannuation. In the context of a total Australian GDP of $1.2 trillion this report concludes that the fiscal impact of these changes is likely to be relatively minor.

Table 17. Additional annual cost to Government and the economy

	Basis 1 (removal of all default cover in superannuation)
	($ million p.a.)
Lost tax due to reduced insurance claim payments	277.0
Lost spending capacity due to reduced insurance claim payments	2493.0
Social security	185.7
Less: Gained tax due to reduced contribution tax concessions	451.9
Less: Gained tax due to reduced earnings tax concessions	40.7
Total	**2,463.1**

The impact of this change on a typical member's retirement account balance is expected to be minor, increasing by only 0.76% with no premium increases and 0.27% with 15% premium increases.

Despite this, given the significant volume of cover which will be removed, many individuals who would have otherwise made claims will be ineligible for insurance benefits. While variable and hard to quantify, this reduction of cover is almost certain to place individuals into significant financial hardship when they are most vulnerable. Thus, should this legislation be passed it will be crucial that funds engage heavily with fund members who are 'at risk' to incentivise them to opt-in to cover.

Appendix A Data sources

A.1 Research – Rice Warner's *Underinsurance in Australia*

For the purposes of this report we have used the model, data and assumptions from Rice Warner's *Underinsurance in Australia Report 2017* with minor adjustments only.

A.2 Research – Rice Warner's *Super Insights*

In estimating the proportion of Australians who would lose their default cover under the proposed changes, this report has leveraged Rice Warner's *Super Insights* study.

Super Insights involves gathering individualised member statement data from a wide range of participating funds. This data provides Rice Warner with over 10 million anonymous accumulation and pension accounts, from which we can aggregate and analyse membership trends. These trends include insurance cover and premiums paid across gender, age, location, account balance and many other categories.

This report has considered data pertaining to the 2014-15, 2015-16 and 2016-17 financial years and a cohort of 19 distinct industry and retail funds.

A.3 Key sources of data

A range of publicly available data sources has been used in the production of this report. These include:

- ABS including census data - this report largely makes use of 2011 census data with some allowance for population totals set out in the recently issued 2016 census data.
- National Centre for Social and Economic Modelling (NATSEM).
- RBA's Hilda Release 15.0, Securitisation System.
- APRA Annual Fund-level Superannuation statistics as at 30 June 2016.
- Social security, tax and superannuation guarantee legislation current as at 1 August 2017.
- Rice Warner superannuation fund and insurance data.
- Social Security Benefits considered:
  - Family Tax Benefit Part A
  - Family Tax Benefit Part B
  - Parenting Payment
  - Child Care Benefit
  - Child Care Rebate
  - Estimating average hours of childcare
  - Disability Support Pension
  - Pension Supplement

- Carer Payment
- Carer Allowance
- Carer Supplement
- Sickness Allowance.

A.4 Key numerical assumptions

Table 18 and Table 19 set out the current assumptions used throughout this report.

Table 18. Key numerical assumptions regarding market parameters

Parameters	Assumptions
Super balance at age 18	$0
Super admin fee $ p.a. (indexed with CPI)	78
Super admin fee % p.a.	0.80%
Annual concessional and non-concessional contributions	$0
CPI	2.5%
AWOTE	3.5%
Proportion of total Australian life insurance provided through Superannuation	80%
Market average profit and expenses	80%

Table 19. Key numerical assumptions regarding individual cameos

Age next birthday	Salary	Premiums
18	10,100	162.10
19	14,800	164.22
20	18,400	166.73
21	21,500	168.03
22	24,100	173.26
23	27,000	174.26
24	30,200	174.30
25	33,000	177.75
26	35,800	187.46
27	37,800	189.72
28	40,400	190.77
29	41,900	192.03
30	43,200	196.25
31	44,100	204.51
32	45,800	206.16

Age next birthday	Salary	Premiums
33	46,800	207.90
34	47,600	209.73
35	48,100	212.61
36	49,200	223.28
37	49,300	226.59
38	49,900	229.86
39	50,000	233.33
40	50,900	238.11
41	50,600	245.54
42	51,100	249.37
43	50,600	253.18
44	51,400	257.48
45	50,800	262.03
46	50,600	268.77
47	50,300	272.89
48	50,700	277.74
49	50,200	281.22
50	50,000	286.67
51	49,700	292.63
52	50,200	297.33
53	49,500	301.91
54	49,000	302.92
55	48,800	305.28
56	49,300	308.72
57	48,800	316.92
58	48,900	317.14
59	47,800	317.42
60	47,500	317.98
61	46,300	309.56
62	45,900	310.00
63	44,500	308.22
64	43,500	309.37
65	42,100	312.28
66	40,200	279.15
67	38,400	293.69