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Committee Secretary

Senate Economics Legislation Committee

PO Box 6100

Parliament House

Canberra ACT 2600

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

Dear Committee Secretary

Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this response to the Committee's inquiry into the *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* (the Bill).

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.6 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 14.8 million Australians with superannuation.

Yours sincerely

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Deputy Chief Executive Officer and Chief Policy Officer

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

General comments

ASFA supports policy initiatives that improve the Australian superannuation system. In particular those initiatives that protect people with low balance accounts, younger members and those who are on low incomes. In this context, default insurance in superannuation should be suitable for each member's needs.

We recognise the aim of the draft Bill to prevent the erosion of accounts through unnecessary insurance premiums but we consider that the proposed measures could be better targeted to prevent people losing insurance who might need it.

We broadly support the ban on exit fees and the fee cap for low balance accounts and we are in favour of giving the ATO the power to actively reunite accounts. However we think it would be simpler and more efficient for the ATO to transfer low balance inactive accounts to other funds directly (rather than sitting at the ATO at all).

These changes will take time to implement and some of our members have questioned the feasibility of a 1 July 2019 start date, especially for the insurance measures. In their current state the proposals will require significant changes to existing contractual arrangements, the need for changes to insurance premiums and the need to cater to additional reporting and administrative requirements. In addition, all measures will involve substantial communication and disclosure costs and obligations.

ASFA notes that the Explanatory Memorandum for the Bill now includes a Regulatory Impact Statement. The Statement notes that the various measures will involve substantial regulatory and administration costs for both funds and individuals – amounts up to $100 million per annum are estimated.

The Statement also notes that adoption of the measures will lead to a significant number of individuals not receiving insurance payouts and also that premiums for groups not directly subject to the measures will increase. Over a lifetime this impact can be substantial which makes the cost to benefit analysis inconclusive.

We also note that these measures will, in part, be defined through regulation and we would welcome the opportunity to participate in any consultation on the drafting of the regulations. We expect that many of the concerns our members have with the various notification and member election requirements related to the insurance measures in particular will need to be resolved through consultation for the regulations.

ASFA also made a submission to Treasury in response to the draft Bill and attach it for your reference (Attachment A).

Detailed comments

1. Schedule 2: Insurance for superannuation members

1.1 No automatic insurance provided to superannuation fund members with an account that has been inactive for 13 months

In the first instance, if this measure becomes law the majority of existing superannuation fund members with insurance currently attached to their inactive account will most likely lose that cover on 1 July 2019. This measure alone has been estimated to remove up to 46 per cent of group life cover currently in force.[1] The majority of those members will lose their only form of insurance held in super - cover they can claim upon in a time of crisis.

Some of these members will actually be people that illness or injury caused superannuation contributions stopping in the first place (and removing them from the system will impact on the ability for them to claim). Some will have left the workforce for a period of time to care for family and some will simply be having a career break or establishing a new business and not be contributing for a period. Many will have had this cover in place for many years, even decades, attached to superannuation balances that could be in the hundreds of thousands of dollars, unsuspecting that their cover could be cancelled by their fund.

ASFA supports insurance being ceased on accounts that are susceptible to extreme and unnecessary benefit erosion. The Explanatory Memorandum released with the Bill indicates that Treasury has estimated that approximately 6 million accounts are below $6,000 and have not received an amount in the last 13 months. Ceasing any insurance cover for these members makes sense if they have not provided a confirmation that they wish to retain it. The majority of perverse outcomes that result from unnecessary premiums being charged to accounts are from this cohort.

However, ASFA does not support cancelling all insurance for all inactive superannuation fund members. Instead those with account balances above $6,000 containing insurance should retain death, terminal illness and total and permanent disability insurances to protect them from what is commonly a catastrophic financial issue if/when any of those events occur. Being an inactive member generally does not eliminate the ability to claim insurance policy for death, terminal illness and TPD cover. However we note this may be the case with IP cover and we support cover being ceased due to contribution inactivity for 13 months regardless of the account balance.

The existence of duplicate insurance is put forward as a reason to cease insurance for inactive accounts. ASFA supports removal of unnecessary duplicate accounts and insurance but notes that the figures provided by Treasury in the Explanatory Memorandum indicate that this is not the case for the majority of Australians. The majority of Australians (approximately 60 per cent) have only one superannuation account, hence one insurance package and for around 11 million Australians with insurance in superannuation approximately 20 per cent have duplicate cover.

In light of the level of underinsurance in Australia and the fiscal benefits of having default insurance in superannuation on an opt-out basis, ASFA urges law makers to continue to support policy settings

[1] KPMG - The impacts and unintended consequences of the proposed Federal Budget changes (June 2018).

that are providing benefits to the majority. ASFA believes that moving low balance (under $6,000) inactive members to an opt-in framework would be a sensible targeted response. This position aligns with the objective of the reforms being to "limit the erosion of retirement balances for younger and low balance account holders".

Some ASFA members have called for the legislation to change to prevent members having to make elections to retain insurance on an inactive account more than once. Requiring members to make an election more than once is an administrative burden for funds and members. This is likely to confuse members and lead to them losing cover unnecessarily by choosing not to make a further election in the belief that they had already made one.

Removal of 68AAA (5) in the Bill would appear to address this concern.

1.2 No automatic insurance provided to superannuation fund members with an account balance below $6,000

As mentioned in 1.1, ASFA supports inactive accounts below $6,000 having all insurances ceased (unless members have consented to retain it).

However ASFA does not support ceasing insurance for existing fund members that have an account balance below $6,000 that are receiving contributions. Similarly, new members should not have to wait until an account balance builds up to $6,000 before insurance is provided to them on an opt-out basis in our view.

In terms of cost, the average cost for default life insurance in superannuation has been estimated to be $3 per week and half that amount for younger members.[2] When this average is considered against average weekly earnings rates for all employees of $1,191.70, premiums are affordable in the context of 9.5 % super guarantee contributions being made for employees.

Delaying the allocation of an opt-out insurance policy to a superannuation account until it builds up or returns to over $6,000 will create a series of unnecessary administration and insurance risk management issues. Anti-selection is common when insurance is voluntary as opposed to default because generally higher risk members will opt-in and lower risk members will not. This will add to the pressure on the prices members will have to pay for insurance in super. Additionally, members will not have cover for quite lengthy timeframes after they join a superannuation fund.

1.3 No automatic insurance for new superannuation fund members under the age of 25

ASFA maintains that if there is to be an age based restriction on providing default insurance in superannuation on an opt-out basis, then age 21 is most appropriate. This will minimise the unintended consequence of these changes and to reflect that 21 is the age by which many Australian's have commenced full-time employment. According to ABS statistics, 40 per cent of employees under 25 are working on a full time basis – approximately 585,000 individuals.

Evidence relating to the insurance needs that this cohort has and the rate of claims that have been paid to these members is compelling.

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[2] Rainmaker June 2018

We outlined in our submission to Treasury that in 2015-16 there were nearly 300,000 households in Australia containing around 450,000 employed persons with the household head less than 25 years of age. There were nearly 60,000 dependent children in such households and in around 100,000 homes; the household head had a spouse.[3]

Additionally, an ASFA superannuation fund member has provided us with information on the frequency of claims paid to younger members. This fund, over the last 16 years has paid 1,036 insurance claims to those under 25 - 733 death benefits totalling $94.4 million and 303 TPD benefits totalling $23 million. For the death benefit claims, for those ages between 21 and 25, approximately 60 per cent of payments went to dependants. An ASFA insurer member has also indicated that the rates of disability claims are the same for people aged 20 and those aged 30.

ASFA notes that AIA, a leading insurer, recently commissioned Rice Warner to undertake research on the impacts of the Government's proposals.[4] This research considered the longer term impacts on individuals' retirement balances in the scenario of opt-out insurance being deferred until age 25. It concluded that when premium rates did not change as a result of the reforms, a marginal 0.76 per cent improvement in retirement balance would arise. In the more likely situation, when insurance premiums increase due to changed risk pooling, this improvement reduces or is even reversed depending on the size of the premium increase. With a 15 per cent increase, as estimated by Rice Warner, the improvement becomes 0.27 per cent only. In similar research undertaken by KPMG[5], the projected premium increase is 26 per cent and at these levels the percentage impact on retirement balances becomes detrimental against current settings.

1.4 Employer sponsor contribution exception

ASFA welcomes the inclusion of an employer sponsor contribution exemption in the Bill.

Some ASFA members have raised concerns about qualifying for this exemption when "hybrid" arrangements occur (sometimes as part of a hybrid defined benefit and accumulation plan). More legislative clarity is sought to ensure that "hybrid" arrangements (where part of an insurance package provided is funded by an employer and another part by the member) does not rule out access to the exception.

In addition, the wording of section 68AAE also appears to require the employer to notify the fund in respect of each member covered by the premium payment arrangement on a quarterly basis. It would seem inefficient for an employer to provide the same notification each quarter in respect of each employee. We recommend employers have the option, if desired, to advise the fund that they will continue to fund the premiums in respect of applicable current and new members until further notice. Given the frequency of fund actuarial and other financial monitoring (and the fact that in many such arrangements premiums are paid to the insurer annually in advance), we would not expect that such an option would undermine the integrity of the Bill.

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[3] ABS – Household Income and Wealth survey 2015-16
[4] Rice Warner – Economic Impact of 2018 Federal Budget Proposed Insurance Changes (May 2018).
[5] KPMG – The impacts and unintended consequences of the proposed Federal Budget changes (June 2018).

ASFA considers that further exemptions should also be introduced to allow those employed in higher risk occupations to retain access to the current opt-out framework. To facilitate this, trustees could seek individual approval from APRA to provide such benefits to "special categories" of members.

In addition, some legacy products will require exemptions to recognise that some existing insurance policies are "paid up" and not requiring of contributions.

ASFA considers that the proposed package of insurance changes should be modified as follows to achieve a better balance between providing insurance benefits and minimising the impact this has on retirement savings:

- Changing the minimum age that automatic cover can be provided to new members to 21
- Allowing new members over any prescribed minimum age being provided with automatic cover immediately upon joining a fund without having to accrue a $6,000 balance
- Removing the obligation on funds to cease death, terminal illness and TPD insurance for inactive accounts when the balance is over $6,000
- Introducing further exemptions to allow funds to provide (and continue to provide) insurance on an opt-out basis to members in higher risk occupations and to allow for legacy products that are "paid up" to not be impacted to the detriment of members.

2. Schedule 1: Fees charged to superannuation members

2.1 Low balance fee limit

ASFA supports the concept of a low balance fee cap (fee cap) and welcomes the changes the Government has made to the original proposal. These changes should make the fee cap easier for funds to implement and reduce the initial and ongoing costs of applying it.

Specifically we welcome:

- The move from two balance day tests per year to one account balance test at the end of the fund's income year
- The removal of the prospective element in the application of the fee cap
- The clarification that S. 99E of the SIS Act does not constrain trustees in their application of the new S. 99G

<u>Treatment of accounts with balances above $6,000 in the 12 months prior to the test day</u>

We are concerned however that the annual balance test could have unintended consequences or be used to minimise fees in high balance accounts as the balance day test, or the test for the day the member ceases to hold the account, does not appear to allow for the possibility of the account having had a higher balance in the previous 12 months.

To demonstrate with an example, a member with a balance of $500,000 retires and transfers $495,000 to an account-based pension but maintains a $5,000 accumulation scheme account

because she knows that she will continue to work occasionally and needs an account to accept employer contributions. It would appear that the proposed method for determining the fee cap in that year would use the $5,000 to set the dollar fee limit (assuming a full year 3% x $5,000 = $150) for the previous 12 months even though the actual fees would have been much higher in dollar terms. For example a total investment and administration expense of 1.5% would translate to $7,500 for a full year. It is obviously not the intention of the fee cap in this example for $7,350 to be refunded to the member but this would seem to be how the fee cap would operate in this scenario.

ASFA recommends that the fee cap be limited to accounts which have remained below $6,000 for all of the previous 12 months. Any account which has at any time in the 12 months prior to the balance day test been above $6,000 should be given an exemption.

<u>Three month window for refunds</u>

We also consider that further clarity is required for the operation of refunds which are processed in the three month window after the original benefit has been paid out or transferred as there appears to be potential for administrative complexity.

<u>Fee cap should not apply to account components</u>

We note that an example has been provided in the Explanatory Memorandum (Example 2.1) that appears to indicate that the fee cap applies only to an account or a 'single beneficial interest' and not to parts or sub-components of that interest. However some of our members have expressed concern that there is still doubt about the scope of the fee cap and that this example could be interpreted as referring to two separate accounts or to one account with choice and MySuper components. As we have argued previously, we recommend that the total account be regarded as a single interest as the alternative is administratively complex and inconsistent with the stated intent of the proposal. In this regard, we would welcome greater clarity on the scope of the fee cap.

<u>Fee cap start date</u>

While some of our members have indicated that they may be able to use existing system functionality established when 'member protection' was still in force to implement the fee cap, a number of other funds have indicated that they are likely to require upgrades to their IT systems and processes and for this reason the start date of 1 July 2019 is problematic.

<u>Pension accounts</u>

It would appear that accounts in the pension phase are caught under the fee cap and we question whether this is intended. This will impose administrative complexity for benefits that are designed to fall below $6,000 and will require refunds to be made within 3 months of the pension being exhausted.

ASFA considers that pension accounts should be excluded from the fee cap in the same way as an exemption has been provided for low balance inactive pension accounts in Schedule 3.

2.2 Prohibition on exit fees

ASFA supports the prohibition on exit fees and welcomes the fact that it will assist low balance

members and those who wish to transfer or withdraw their benefit. However we note that the cost of processing exits will now fall on the broader membership.

ASFA does not support the ban on exit fees for partial withdrawals. This ban will increase costs for the broader membership and do nothing to reduce the number of duplicate accounts. It may also result in some trustees no longer offering partial withdrawals due to the inequitable cost allocation between members who make full benefit as opposed to partial withdrawals. This would be an unfortunate result for members.

ASFA considers that Family Law splitting payments should also be exempt from the ban on exit fees.

ASFA supports:

- Measures that prevent the unnecessary erosion of people's retirement balances by fees
- The proposal to ban exit fees
- The introduction of a fee cap but with certain qualifications.

These proposals will require significant system and product changes and a longer implementation timeframe would assist members to make the necessary changes.

ASFA does not support the ban on exit fees:

- for partial withdrawals
- Family Law splitting payments.

3. Schedule 3: Inactive low-balance accounts and consolidation into active accounts

3.1 Payment of inactive accounts below $6,000 to the ATO

Members should be able to elect to maintain a low balance inactive account

ASFA supports the reuniting of low balance inactive accounts with a member's active account unless the member wishes to maintain the low balance account for whatever reason such as, insurance, to accept a transfer or to make a contribution in the future.

Members should be able to elect to maintain a low balance account if they wish to. The current proposal only permits this in cases where the member wishes to maintain his or her insurance benefit or where the member makes a voluntary contribution.

Where insurance does not apply, the requirement to make occasional contributions would be burdensome for the member who would have to keep track of the 13 month deadline and arrange for a contribution to be made. Members of certain non-public offer funds are unable to make member contributions while the account is inactive due to the scheme rules and not being able to make a contribution will mean these members have no means of preventing a transfer to the ATO.

ASFA is in favour of a mechanism which permits someone to elect to keep his or her superannuation

in an account either explicitly or implicitly. This could be through a specific election, changing investment options, changing address and notifying the fund or electing to maintain insurance. Such an election or account activity should supersede receiving no contributions for 13 months (or as ASFA prefers two years).

The period used to determine inactivity should be extended from 13 months to two years

13 months is a relatively short timeframe for the determination of inactivity and a member may have perfectly straightforward reasons for such inactivity including maternity leave, carers' leave and extended leave for travel or study. On the assumption that lack of contributions will be the primary determinant of inactivity the 13 months should be extended to two years and we note that the Productivity Commission's draft report recommends that the lost inactivity threshold be set at two years. This timeframe would provide greater assurance that the member is genuinely lost or disengaged.

Members may be worse off at the ATO

We consider that there needs to be careful consideration over whether it is in a member's best interest to transfer low balance accounts when the member only has one account and no alternative active account to which the inactive account could be transferred.

ASFA has conducted analysis into the relative performance of low balance accounts compared with those held by the ATO and we have found that for members with balances below $6,000 they are likely to be better off if their account remains with a fund due to the higher investment returns.

The regime for lost, inactive and insoluble accounts needs to be reviewed

The current system of defining lost, inactive and insoluble accounts and the addition of the low balance inactive category make an already complex area even more confusing. We consider that a comprehensive review of these categories and their application should occur once the revised regime is operational to address inefficiencies and unintended consequences, including definitions.

Reporting

ASFA members have identified administrative complexities for the transfer of inactive low balance accounts arising from the potential use of the existing Rollover Message as prescribed under the Superannuation Data and Payments Standards 2012 and the RSA Data and Payment Standards 2013. We recommend that the ATO work collaboratively with the industry to develop efficient delivery methods for such transfers, for example using the next version of the Rollover Message and its SuperStream enhancements due for release in November 2019.

We also question the usefulness of reporting those accounts which were identified as inactive on the unclaimed money day (e.g. June 30) but which have ceased to meet the definition on the following statement day (e.g. October 31). This practice used to apply to the unclaimed money process statements but was abandoned as part of the SuperStream redesign this year due to the information having little or no practical use for the ATO. The Explanatory Memorandum advises that these reporting requirements are modelled on the 'existing lost member regime' and this reporting requirement should be revised and made consistent with the recent changes described above.

3.2 Consolidating accounts with the ATO into active superannuation accounts

We consider that the ability of the ATO to reunite lost superannuation with an active account is a compelling reason why the ATO should move the money directly from an inactive account to an active account rather than it going to the ATO, particularly due to the higher investment returns available in a superannuation fund account.

However should the money be required to go to the ATO or for the money that is already held there, we consider that the ATO needs to be accountable for reuniting the super benefit with people's active accounts as quickly as possible to ensure people benefit from the higher fund returns.

We recommend that strict deadlines should apply to the Commissioner for the return of members' money to their active accounts. We note that the Explanatory Memorandum indicates that the ATO will be able to reunite inactive accounts with active accounts within a month and we regard this as a reasonable timeframe and a yardstick against which future performance will be measured. The longer it takes the ATO to reunite inactive with active accounts the greater will be the impact on members through foregone investment returns (and currently this is likely to be higher than CPI).

In addition, we consider that the current stock of lost and inactive super at the ATO should be reunited with active accounts as soon as possible, at a minimum before further inactive accounts are sent to the ATO (i.e. before the commencement date of this measure of 1 July 2019).

Where a member has more than one inactive account but no active account, ASFA supports consolidation directly into the most active account, with active as defined under the co-contribution payment rules (see c.5, Item 4, *Superannuation (Government Co-contribution for Low Income Earners) Regulations 2004*) or as the account with the most recent activity or the highest balance.

We also note that the effect of the fee cap, ban on exit fees and the insurance measures will act to remove most of the benefits of low balance inactive account transfers to the ATO identified in the Explanatory Memorandum.

ASFA supports:

- Reuniting super with active accounts by the ATO directly (rather than going through the ATO)
- Defining inactive super as no contributions for two years rather than 13 months (consistent with the Productivity Commission) reflecting that women, in particular, may have lengthy breaks from the workforce
- A mechanism that allows someone to elect to keep his or her superannuation in an account either explicitly or implicitly
- The reporting requirements to be made consistent with modern SuperStream requirements and for the start date to be delayed to match the introduction of new data standards
- If inactive super goes to the ATO (and for the current stock), strict processing timelines to prevent funds being held at the ATO for lengthy periods.