Chapter 1

Introduction

1.1 On 21 June 2018, the Senate referred the provisions of the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 (the bill) to the Economics Legislation Committee (the committee) for inquiry and report by 13 August 2018.[1]

1.2 The bill implements the *Protecting Your Superannuation package* announced in the 2018–2019 Budget. The overarching objective of the reforms contained in the bill is to protect individuals' retirement savings from undue erosion, ultimately increasing Australians' superannuation balances. In particular, the bill aims to limit the erosion of retirement balances for young and low balance account[2] holders.

1.3 The bill amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act), the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (SUMLM Act), *Income Tax Assessment Act 1997* (ITAA 1997), and the *Taxation Administration Act 1953* (TAA 1953).

1.4 As summarised in the Explanatory Memorandum, the bill seeks to protect members' superannuation savings from erosion by:

- limiting fees so that low balance savings can grow and are protected from disproportionately high fees;
- banning exit fees to remove a barrier to account consolidation;
- ensuring that arrangements for insurance in superannuation are appropriate so that members are not paying for insurance cover that they do not know about or premiums that inappropriately erode their retirement savings; and
- strengthening the ATO's role in reuniting small, inactive balances to reduce the costs to members and consolidate the accounts of members that have accrued multiple superannuation accounts.[3]

1.5 Following the announcement of the *Protecting Your Superannuation package* in the 2018–2019 Budget, the Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, commented that:

> Together, these measures build on the Government's overarching reform agenda for superannuation—an agenda that is focused solely on improving outcomes for superannuation members. This includes those members with interrupted work patterns and low incomes—which disproportionately

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1 *Journals of the Senate*, No. 101, 21 June 2018, p. 3242.

2 The term 'account' is used as it is commonly understood in the superannuation sector, meaning a member's interest in either a MySuper product or a choice product held within their superannuation fund.

3 *Explanatory Memorandum*, pp. 6–7.

> include women—as well as those who have inadvertently accrued multiple accounts.[4]

1.6 On introduction of the bill to Parliament, the Minister acknowledged that the proposed reforms 'will involve some substantial changes' from an industry perspective, however emphasised that, by ensuring superannuation arrangements are appropriate to members' circumstances, the bill is in the best interest of all Australians:

> …I firmly believe that this bill, which will benefit young members, members with low balances such as low-income earners and members with multiple accounts, is in the best interest of all Australians.
>
> After all, we must never forget the most important foundation stone in superannuation—your superannuation is your money.
>
> It is not the government's, not the industries', not the bank executives', not the shareholders', not the employers', and not the trade unions'.[5]

Conduct of the inquiry

1.7 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting written submissions by 9 July 2018.

1.8 The committee received 34 submissions as well as additional information and answers to questions on notice, which are listed at Appendix 1.

1.9 The committee held a public hearing for the inquiry in Sydney on 20 July 2018. The names of witnesses who appeared at the hearing can be found at Appendix 2.

1.10 References to the Committee Hansard are to the Proof Hansard and page numbers may vary between Proof and Official Hansard transcripts.

1.11 The committee thanks all individuals and organisations who assisted with the inquiry, especially those who made written submissions and participated in the public hearing.

Context of amendments

1.12 Superannuation plays a central role in funding individuals' retirement and represents a significant financial asset for many Australians. Today, Australia's superannuation system has accumulated over $2.6 trillion in assets collectively owned by nearly 15 million members.[6] The superannuation system's efficiency and performance is therefore integral to the wealth and wellbeing Australians and,

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4 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Encouraging and rewarding Australians by protecting your superannuation', *Media Release*, 8 May 2018.

5 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, *House of Representatives Hansard*, 21 June 2018, pp. 19–20.

6 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 3.

moreover, is critical to meeting the economic and fiscal challenges posed by an ageing population.

Erosion of low balance accounts through fees and insurance premiums

1.13 Under the current superannuation regulatory framework following the removal of the former Member Protection Standards by the Labor Government in 2013, there are no distinct protections from the erosion of retirement savings through fees and life insurance premiums for low balance accounts.[7]

1.14 The Explanatory Memorandum states that:

> Low balance account holders are usually young members, who generally have lower superannuation balances, as well as low income earners (who disproportionately include women) and seasonal workers. Typically, these people are disengaged from superannuation and do not actively monitor or organise their accounts to minimise erosion of balances.[8]

1.15 Low balance accounts comprise a significant proportion of the superannuation system. Treasury analysis using 2015–16 data from the Australian Taxation Office (ATO) shows that, as at 30 June 2016, there were approximately 9.5 million accounts with balances of $6000 or less. This accounts for roughly 40 per cent of all accounts in the superannuation system. Additionally, of these low balance accounts, more than 60 per cent had not received a contribution or rollover within the preceding 13 months.[9]

1.16 Low balance accounts are particularly vulnerable to erosion by fees and insurance premiums. Fee rules for MySuper products[10] generally require that fees be charged to all members on the same basis. With regard to insurance premiums, superannuation fund trustees are generally required to provide default[11] MySuper members with default death and total and permanent disability (TPD) insurance on an opt out basis. Some trustees also bundle default death and TPD insurance with income protection (IP) insurance unless members choose to opt out.[12]

1.17 Superannuation fund trustees must only offer insurance coverage if it does not inappropriately erode members' retirement savings. However, as explained in the explanatory memorandum, this requirement is impeded due to a lack of visibility of members' other superannuation accounts:

> Under the current insurance covenant, trustees must only offer insurance coverage if it does not inappropriately erode the retirement savings of

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7 *Explanatory Memorandum*, p. 42.

8 *Explanatory Memorandum*, p. 42.

9 *Explanatory Memorandum*, p. 42.

10 A MySuper product is a default defined contribution superannuation product. Superannuation funds must meet requirements set by APRA to be permitted to offer a MySuper product. All default products are MySuper products since 1 July 2017.

11 A default fund is a superannuation fund to which an employer's Superannuation Guarantee contributions are paid if the employee does not choose an alternative fund.

12 *Explanatory Memorandum*, p. 43.

> members. However, even where trustees comply with this obligation, they do not have visibility of members' other superannuation accounts with insurance. In addition, the obligation to provide all MySuper members with opt out death and TPD insurance means that trustees are required to provide all new default members with insurance, meaning that multiple accounts with insurance can be accrued with ease under current settings.[13]

Multiple superannuation accounts

1.18 The current default system where members are potentially allocated to a new superannuation fund each time they begin a new job, as well as past and current restrictions on members' ability to choose their fund, have resulted in many individuals holding multiple superannuation accounts. This compounds the problem of retirement balance erosion through fees and life insurance premiums.[14]

1.19 Treasury analysis using 2015–16 data from the ATO shows that, of the approximately 11 million Australians with insurance in superannuation, about 2.5 million (over 20 per cent) of individuals have duplicate cover. Moreover, over 10 per cent of duplicate coverage holders are under 25 years of age.[15] ATO data also shows that, as at 30 June 2017, approximately 40 per cent of superannuation account holders had more than one account.[16]

1.20 Under the current legislation, responsibility for locating and consolidating superannuation from multiple accounts generally falls on individual account holders. Account holders must contact either their superannuation funds or the ATO (depending on timing of inactivity on the account) and request consolidation.[17] Actual consolidation of accounts is therefore dependent on member engagement and assessment of need.[18]

Overview of the bill

1.21 The bill contains three schedules:

- Schedule 1—Fees charged to superannuation trustees
- Schedule 2—Insurance for superannuation members
- Schedule 3—Inactive low-balance accounts and consolidation into active accounts

1.22 The measures proposed in the bill come into effect from 1 July 2019.

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13 *Explanatory Memorandum*, p. 43.

14 *Explanatory Memorandum*, pp. 43–44.

15 *Explanatory Memorandum*, p. 43.

16 *Explanatory Memorandum*, p. 43.

17 *Explanatory Memorandum*, p. 44.

18 *Explanatory Memorandum*, p. 45.

Schedule 1—Fees charged to superannuation trustees

Cap on fees and costs

1.23 Schedule 1 to the bill prevents trustees of superannuation funds from charging certain fees and prescribed costs[19], exceeding three per cent of the balance of a MySuper or choice product annually, where the balance of the account is below $6000.[20]

1.24 The fees that are capped are administration and investment fees. Administration and investment fees represent the majority of fees charged by funds. These fees are incurred by members simply by virtue of holding a product with a superannuation fund.[21]

1.25 Currently, the SIS Act does not limit the amount of administration fees or investment fees that can be charged for either MySuper or choice products. Schedule 1 to the bill amends the general fee rules under Part 11A of the SIS Act to introduce a 'fee cap' (a maximum of three per cent of a member's account balance) which restricts the total amount of administration fees, investment fees and prescribed costs that can be charged where the balance of an account is less than $6000 at the end of the fund's income year or at the time of account closure.[22]

1.26 If a trustee has charged more than the amount allowed under the fee cap the trustee must refund the excess above the cap within three months of the end of the fund's income year.[23]

Prohibition on exit fees

1.27 Schedule 1 to the bill also amends the general fee rules under the SIS Act to prevent trustees from charging exit fees (other than a buy-sell spread)[24] on all superannuation accounts, regardless of a member's account balance.[25] Under this proposed measure, a trustee must not charge an 'exit fee', which is a fee related to the disposal of all or part of a member's interest in a fund.[26]

Schedule 2—Insurance for superannuation members

1.28 Currently, under section 68AA of the SIS Act, trustees are required to provide MySuper members with death and TPD insurance cover on an opt out basis, unless a reasonable condition applies. There are no similar requirements for members who

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19 The term 'prescribed cost' refers to an amount prescribed in regulations (if any) incurred by the trustee for the administration of the fund or investment of the fund's assets which are not charged to the member as a fee.

20 *Explanatory Memorandum*, p. 9.

21 *Explanatory Memorandum*, p. 9.

22 *Explanatory Memorandum*, pp. 9–11.

23 *Explanatory Memorandum*, pp. 10 and 13.

24 A buy-sell spread is the transaction cost incurred by a trustee of a superannuation entity when they buy or sell the assets of the entity.

25 *Explanatory Memorandum*, pp. 9 and 10.

26 *Explanatory Memorandum*, pp. 9 and 10.

hold a choice product; however, some trustees of choice products choose to provide insurance on an opt out basis.[27]

1.29 Schedule 2 to the bill amends the SIS Act to prevent a trustee[28] from offering or maintaining default insurance cover for certain members unless the member has elected to obtain or maintain the insurance provided.[29]

1.30 The circumstances when a trustee cannot provide opt out insurance for a member of either a MySuper or choice superannuation account are when:

- the member is under the age of 25 and begins to hold the superannuation account on or after 1 July 2019;
- the balance of the account is less than $6000 and has not been $6000 or more on or after 1 April 2019; or
- the account has been inactive for a continuous period of 13 months or more.[30]

1.31 For existing members, trustees must notify the affected members of the changes on or before 1 May 2019 so as to give these members an opportunity to elect to continue with their insurance cover beyond 1 July 2019 through their fund. The changes do not apply to existing members under the age of 25, where the person's account has a balance of $6000 or more and the account has not been inactive for 13 months.[31]

1.32 From 1 July 2019, the trustee must ensure that each member affected by these amendments can direct the trustee to take out or maintain their insurance cover. Directions by members in respect of their insurance must be made in writing.[32]

1.33 Members who elect to maintain insurance in inactive accounts with balances of less than $6000 will not have their balances transferred to the Commissioner of Taxation (Commissioner) under the changes contained in Schedule 3 of the bill.[33]

Schedule 3—Inactive low-balance accounts and consolidation into active accounts

Payments and statements for inactive low-balance accounts

1.34 The SUMLM Act currently prescribes a number of circumstances under which a superannuation provider or retirement savings account (RSA) provider must provide statements and pay amounts to the Commissioner.

1.35 Schedule 3 to the bill amends the SUMLM Act to include an additional circumstance when superannuation and RSA providers must pay the balances of

27 *Explanatory Memorandum*, p. 18.

28 The new insurance rules do not apply to self-managed super funds (SMSFs) or small APRA funds.

29 *Explanatory Memorandum*, p. 19.

30 *Explanatory Memorandum*, p. 19.

31 *Explanatory Memorandum*, p. 18.

32 *Explanatory Memorandum*, p. 19.

33 *Explanatory Memorandum*, p. 21.

accounts to the Commissioner. Specifically, where a MySuper account or choice superannuation account has been inactive for 13 months and the balance of the account is less than $6000, the balance of that account must be paid to the Commissioner, unless the member has chosen to opt in to have insurance through that superannuation account.[34]

Consolidating accounts held by the Commissioner into active superannuation accounts

1.36 Currently, the SUMLM Act only allows the Commissioner to consolidate the amounts he or she holds for a person with amounts held in a fund when the person directs the Commissioner to do so. The amendments in Schedule 3 to the bill also give the Commissioner the power to proactively consolidate the amounts he or she holds with an active account held by the person in a superannuation fund where the reunited balance would be greater than $6000.[35]

1.37 The initial transfer of inactive low-balance accounts to the Commissioner will take place during the 2019–20 financial year which will also be when the Commissioner begins to proactively reunite monies currently held.[36] The ATO has estimated that it will be able to reunify amounts within a month of receiving the funds.[37]

Consultation

1.38 Stakeholder consultation on exposure draft legislation to implement the *Protecting Your Super package* commenced on Budget night and closed on 29 May 2018. Treasury received 45 submissions in response to this consultation, eight of which were confidential.[38]

1.39 Three policy options were considered during the Treasury consultation. The preferred option (reflected in the bill) was determined to be the best approach as it provides the greatest benefit to members at the lowest regulatory burden.[39]

Related matters

PC Inquiry—Efficiency and competitiveness of Australia's superannuation system

1.40 In April 2018, the Productivity Commission (Commission) released its draft report for the inquiry into the efficiency and competitiveness of the Australian superannuation system.[40]

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34 *Explanatory Memorandum*, p. 27.

35 *Explanatory Memorandum*, p. 28.

36 *Explanatory Memorandum*, p. 28.

37 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, *House of Representatives Hansard*, 21 June 2018, p. 19.

38 Treasury, *Protecting Your Super package*, https://treasury.gov.au/consultation/c2018-t286292/ (accessed 7 August 2018).

39 *Explanatory Memorandum*, p. 3.

1.41 Among its draft findings, the Commission found that 'higher fees are clearly associated with lower net returns over the long term' and 'have a significant impact on retirement balances'. It noted that:

> …an increase of just 0.5 per cent a year in fees would reduce the retirement balance of a typical worker (starting work today) by a projected 12 per cent (or $100 000).[41]

1.42 In assessing the erosion of member balances, the Commission found that:

> The superannuation system, primarily due to its policy settings, does not minimise the unnecessary and undesirable erosion of member balances. This erosion is substantial in size and regressive in impact.[42]

1.43 The Commission identified unintended multiple accounts (which it estimated at ten million total accounts—one in three accounts in the system) as being the most egregious driver of balance erosion, finding that this is 'directly costing members nearly $2.6 billion a year in excess insurance premiums and administration fees'.[43]

1.44 The Commission also recommended that exit fees be limited to cost-recovery levels.[44]

1.45 With regard to insurance in superannuation, the Commission found that the deduction of insurance premiums 'can have a material impact on member balances at retirement', describing this balance erosion as being 'highly regressive in its impact'.[45] The Commission's draft report further noted that balance erosion due to the deduction of insurance premiums:

> …is more costly to members with low incomes. It also has a larger impact on members with intermittent attachment to the labour force, and those with multiple superannuation accounts with insurance (the latter comprise about 17 per cent of members).[46]

1.46 Additionally, while insurance in superannuation was recognised as offering good value for many members, it was found that:

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40 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report*, accessible at: https://www.pc.gov.au/inquiries/current/superannuation/assessment/draft (accessed 13 August 2018).

41 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 47.

42 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 51.

43 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 51.

44 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 39.

45 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 53.

46 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 53.

> For some members, insurance in superannuation is of little or no value — either because it is ill-suited to their needs or because they are not able to claim against the policy. Income protection insurance and unintended multiple insurance policies are the main culprits for policies of low or no value to members. Younger members and those with intermittent labour force attachment — groups which commonly have lower incomes — are more likely to have policies of low or no value to them.[47]

1.47 Finally, the Commission suggested that the ATO should be empowered to clean up the legacy stock of existing multiple accounts in the system, including by more actively reuniting lost balances with members (unless a member actively rejects consolidation) and being a sole operator of a 'holding account' for lost super.[48]

Regulatory Guide 97 review

1.48 *Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (RG 97) sets out the Australian Securities and Investments Commission's (ASIC's) guidance for superannuation funds and managed investment schemes on how to disclose fees and costs in Product Disclosure Statements (PDSs) and periodic statements.

1.49 In November 2017, ASIC announced that it would appoint an external expert to conduct a review into RG 97. The review was undertaken in response to strong feedback from across the industry around challenges with the practical implementation of RG 97.[49]

1.50 ASIC released the external report into RG 97 on 24 July 2018. The report concluded that changes to fees and costs disclosure would be advantageous. It included discussion around the inconsistencies between the fees and costs disclosure requirements for superannuation products.

1.51 ASIC welcomed the report and agreed that changes to the disclosure regime are in the interests of consumers and the industry, noting its intention to release a consultation paper setting out its proposed response to the issues raised in the report in the first half of the 2018–19 financial year.[50]

47 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 53.

48 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness—Draft Report—Overview*, April 2018, p. 35.

49 Australian Securities and Investment Commission, *RG 97 review*, https://asic.gov.au/regulatory-resources/superannuation-funds/fees-and-costs-disclosure/rg-97-review/ (accessed 7 August 2018).

50 Australian Securities and Investment Commission, 'External report on fees and costs disclosure welcomed by ASIC', *Media Release*, 24 July 2018.

Financial impact

1.52 The measures in the bill are estimated to have a gain to the budget of approximately $850 million in fiscal balance terms and around $1.75 billion in underlying cash balance terms over the forward estimates.[51]

Compatibility with Human Rights

1.53 As required under the *Human Rights (Parliamentary Scrutiny) Act 2011*, the government has assessed the bill's compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The government considers that the bill is compatible.[52]

51 *Explanatory Memorandum*, p. 3.

52 *Explanatory Memorandum*, p. 73.