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Economics
Legislation Committee

Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 [Provisions]

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Senate Economics Legislation Committee

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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

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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]

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]

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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.

Chapter 2

Views on the bill

2.1 This chapter summarises the views held by stakeholders on the provisions of the bill and its effects. The chapter first considers views with regard to the implementation timeframe of the measures proposed and the definition of an 'inactive' account. It then considers matters raised in relation to each schedule of the bill in turn. The chapter is intended to provide an indicative, though not exhaustive, account of issues examined during the committee's inquiry.

General support for the bill

2.2 Submitters and witnesses were broadly supportive of the policy objective of the bill; that is, to improve Australians' retirement savings by protecting low-balance accounts from undue erosion due to excessive fees and inappropriate insurance arrangements. However, inquiry participants differed in terms of the extent to which they believed the measures proposed by the bill effectively meet this policy objective.[1]

2.3 ClearView expressed its full support for the bill and noted that the legislation is in keeping with the Productivity Commission's recent draft report, *Superannuation: Assessing Efficiency and Competitiveness*:

> ClearView fully supports the Bill and believes it will be effective in reducing the erosion of Australians' superannuation savings stemming from fees on low balance accounts, inappropriate group insurance in superannuation and certain barriers to account consolidation.[2]

2.4 COTA Australia welcomed the *Protecting Your Superannuation package* and its 'intention to strengthen the retirement balances of Australians by ensuring low-balance superannuation accounts are not eroded with fees and insurance premiums'.[3]

2.5 Anglicare Australia commended the government for the changes proposed in the bill, highlighting the benefits of the measures for low-income earners and individuals with sporadic work histories:

> The proposed measures will help unite people with their superannuation and prevent any low-balance accounts from being eroded; something of great assistance to people on low incomes and with work histories that have seen them earn small amounts over their working life. This is particularly important to women who have taken years out of the workforce to care for

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1 See, for example, Industry Super Australia, *Submission 26*, p. 3; Rice Warner, *Submission 7*, p. 1; Chartered Accountants Australia and New Zealand, *Submission 8*, p. 1; MetLife Insurance Limited, *Submission 9*, p. 2.

2 ClearView Wealth, *Submission 2*, p. 1.

3 COTA Australia, *Submission 30*, p. 1.

> children and those who have worked part time for several years to fit in with caring duties.[4]

2.6 Dixon Advisory expressed overarching support for the bill, and argued that 'the legislation will improve practices within the superannuation system' and ensure that 'regulatory arrangements are focused on the fundamental objective of superannuation to provide for retirement incomes for all Australians'.[5]

2.7 The Financial Rights Legal Centre (Financial Rights) and Consumer Action Law Centre (Consumer Action) also expressed their strong support for the bill in their joint submission to the inquiry, characterising the changes proposed by the bill as a 'significant improvement on the status quo':

> The Financial Rights Legal Centre (Financial Rights) and the Consumer Action Law Centre (Consumer Action) strongly support the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 (the Bill). For too long, the design of the superannuation regime has led to a proliferation of accounts and serious erosion of people's retirement savings. The Bill takes important steps to address the issues and represents a significant improvement on the status quo.[6]

2.8 Similarly, Financial Counselling Australia (FCA) noted that it supports the *Protecting Your Superannuation package* in principle, and 'considers that these reforms should be a first step of a continuing process to ensure that superannuation grows for all people'.[7]

2.9 The Grattan Institute (Grattan) expressed its support for the bill in both principle and detail. Grattan submitted that the bill 'will substantially reduce the costs of superannuation', further contending that:

> It will constrain inappropriate income protection, life and total and permanent disability insurance (TPD), resulting in higher superannuation balances at retirement for many Australians. And it may increase competition between superannuation providers a little, lowering superannuation fees.[8]

2.10 CHOICE argued that '[f]or too long poor system design and industry inaction has led to a proliferation of accounts and serious erosion of people's retirement savings'. CHOICE summarised how the measures in the bill benefit Australians in saving for their retirement:

> Reuniting people with their inactive superannuation accounts will help to fix one of the costliest problems facing Australians in saving for their retirement. The $6 billion in superannuation expected to go back to the

4 Anglicare Australia, *Submission 1*, [p. 1].

5 Dixon Advisory, *Submission 4*, p. 1.

6 Financial Rights Legal Centre and Consumer Action Law Centre, *Submission 11*, p. 1.

7 Financial Counselling Australia, *Submission 29*, p. 1.

8 Grattan Institute, *Submission 33*, p. 2.

> accounts of three million members will have tangible benefits later in life. For some this will mean the difference between worrying about how they will afford the next energy bill or weekly shop and being able to retire in comfort.
>
> The proposed improvements to life insurance targeting will deliver big benefits to younger people and people on low incomes. From inception the policy of default opt-out life insurance in superannuation has lacked a well-developed purpose. As a result, we have seen many people paying for insurance they do not know they have and in some cases do not require.[9]

2.11 In its submission, AIA Australia (AIAA) recognised the need for reforms 'to improve the system and deliver the right balance of appropriate protections to suit all members needs'. However, AIAA expressed concern that there will be unintended consequences of the reforms:

> 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.[10]

2.12 The Association of Financial Advisers (AFA) expressed similar concerns, submitting:

> The AFA supports the overall objective of avoiding unnecessary erosion of superannuation balances, including through the avoidance of paying fees and insurance premiums on duplicate accounts, however we believe that there are many potential unintended negative consequences that could flow from this package and we caution against it being pushed through without adequate consultation and consideration of the objectives and the likely consequences.[11]

2.13 A number of industry representatives urged caution to avoid unintended consequences of the proposed changes implemented by the bill. For example, Cbus Super argued that 'it is imperative that achieving this policy objective does not create unintended adverse impacts on members', highlighting that:

> Cbus has strong reservations about the extent to which the Bill will remove and restrict access to default group insurance for those workers in more hazardous industries who require cover or would not otherwise be able to access it.[12]

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9 CHOICE, *Submission 15*, p. 3.

10 AIA Australia, *Submission 17*, p. 2.

11 Association of Financial Advisers, *Submission 24*, p. 1.

12 Cbus Super, *Submission 32*, p. 1. See also TAL Life Limited, *Submission 31*, p. 2; Financial Services Council, *Submission 25*, p. 1; Australian Institute of Superannuation Trustees, *Submission 10*, p. 1.

Implementation timeframe

2.14 The measures proposed in the bill come into effect from 1 July 2019. Several inquiry participants, particularly industry representatives, expressed strong concerns in relation to the proposed timeframe to implement the measures in the bill, arguing that the application date of 1 July 2019 will be challenging to achieve.[13] A number of submitters and witnesses argued that transition to the new regime should either be deferred or that a staged approach be adopted.

2.15 Concerns regarding the implementation timeframe largely centred around the ability of industry to action the life insurance measures contained under Schedule 2 of the bill.

Repricing of insurance contracts

2.16 In particular, submitters and witnesses raised the need for superannuation funds to redesign and renegotiate group insurance contracts with insurers; a process which several inquiry participants contended takes significant time and resources from both the fund and the insurer.[14]

2.17 For example, as outlined by Rice Warner:

> Given the significance of these changes, funds will likely need to renegotiate the terms of their contracts with insurers. This is a process which requires significant time and resources from both the fund and the insurer. This exercise would generally commence at least one year before implementation and for most funds occurs every three years. This means that insurers will require considerably more resources to be able to deal with pricing requirements. Funds that have recently renegotiated premium rates with premium guarantees of three years will be forced to pay to go through the exercise again and the outcome for members may be a large premium increase. Where the incumbent insurer increases premiums to an extent that the trustee does not feel is justified, funds will have insufficient time to tender for insurance services.[15]

2.18 Mercer also pointed to the need to re-price insurance contracts that will arise as a consequence of the bill and questioned the ability of insurers to conduct a 'thorough reassessment of risk' within the necessary timeframe:

> A start date of 1 July 2019 would require the group insurance terms and conditions to be reviewed for every large super fund by early 2019 at the

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13 See, for example, Mr Allan Hansell, Director of Policy and Global Markets, Financial Services Council, *Committee Hansard*, 20 July 2018, p. 33; Corporate Superannuation Association, *Submission 6*, pp. 4–5; Munich Reinsurance Company of Australasia Limited, *Submission 13*, p. 5; Law Council of Australia, *Submission 20*, p. 3; Rest, *Submission 22*, p. 10.

14 See, for example, Financial Services Council, *Submission 25*, p. 2; Cbus Super, *Submission 32*, p. 12; Law Council of Australia, *Submission 20*, p. 3; AIA Australia, *Submission 17*, p. 14; Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, pp. 2–3.

15 Rice Warner, *Submission 7—Attachment 1*, p. 7. See also Ms Jenni Baxter, Executive General Manager, Insurance, Rice Warner, *Committee Hansard*, 20 July 2018, p. 25.

> latest. A one-size-fits-all approach is not possible as individual fund characteristics such as the proportion of new members under age 25 and the number of inactive accounts will vary significantly from fund to fund, as will their current terms and conditions. Doubts have already been raised about the capacity of the group insurers to conduct a thorough reassessment of risk for every fund within the necessary timeframe, as well as whether there is sufficient data available to allow accurate assessment of the impact of the changes on claim rates.[16]

2.19 Also commenting on the ability of industry to execute the changes proposed by the bill, TAL Life Limited (TAL) reflected on the complexity of the superannuation system and outlined the changes the bill will require in addition to the redesign and negotiation of insurance contracts:

> The changes the Bill will require include:
>
> - Redesign, repricing and negotiation of all life insurance policies and possibly, administration agreements and reinsurance contracts;
> - Extraction and collation of appropriate member data;
> - Drafting and finalising member communications to engage members on the implications of 1 July 2019 (being the current proposed implementation date);
> - Reflecting the new arrangements within PDSs, insurance guides and other member facing documents and websites; and
> - Creation and testing of new business rules/IT and system builds to implement the changes.[17]

Concern of possible detriment to members

2.20 Some submitters and witnesses argued that the proposed timeframe to implement the changes in the bill will increase the operational risk for insurers and superannuation trustees, and that this in turn may lead to unintended outcomes for members such as increased premium rates and risks of miscommunication.[18]

2.21 Mercer summarised this concern it its submission, commenting that 'the more rushed the implementation timetable, potentially the worse the outcome for the majority of fund members'.[19]

2.22 Rest submitted that:

> These budgetary changes will take considerable time to implement and involve administration and supporting system work, operational change management and extensive member and employer communications. Creating a new insurance policy that is in the best interests of members

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16 Mercer, *Submission 19*, p. 9.

17 TAL Life Limited, *Submission 31*, p. 3.

18 See, for example, RGA Reinsurance Company of Australia Limited, *Submission 14*, p. 3; AIA Australia, *Submission 17*, pp. 14–15.

19 Mercer, *Submission 19*, pp. 10–11.

> takes time to create and price. Rushing the pricing of a contract will lead to additional loadings due to lack of time to properly analyse claims experience.[20]

2.23 The Financial Services Council (FSC) asserted that limited time for detailed analysis in contract renegotiations will result in conservatism being built into the system as well as additional implementation costs being incurred for additional staff and outsourcing. The FSC further contended that 'these are likely to result in additional costs and premium increases to the detriment of members'.[21]

2.24 Commenting on the timeframe allowed by the bill to communicate with members the changes to their insurance arrangements, Munich Reinsurance Company of Australasia Limited (MRA) submitted:

> A very significant number of members will need to be notified across the industry of the change to their insurance arrangements. Where a member is required to respond, they may be given a very short time frame to make an election before the cover is cancelled. MRA is concerned that this may result in unintended consequences, such as correspondence not being acted upon due to unforeseen circumstances.[22]

2.25 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority (APRA), also relayed concerns to the committee regarding the potential unintended consequences for members that may arise if there is insufficient time to implement the proposals in the bill:

> To implement all of these proposals, funds will need to work closely with their administrators and insurers to ensure the required system changes and amendments to group insurance arrangements are in place. This will be challenging to achieve by the proposed implementation date of 1 July 2019, given both the complexity and extent of the changes that will be required to be made across the entire superannuation sector.
>
> …
>
> APRA is therefore concerned that unintended consequences may arise for members and that there will be significant pressure on and heightened operational risk for super funds and their insurers and administrators if sufficient time is not allowed to implement the proposals in an appropriate and orderly manner.[23]

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20 Rest, *Submission 22*, p. 10.

21 Financial Services Council, *Submission 25*, p. 2.

22 Munich Reinsurance Company of Australasia Limited, *Submission 13*, p. 5.

23 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 2.

Calls for deferred or staged implementation

2.26 A number of inquiry participants urged that consideration be given to the start date of the measures in the bill being deferred.[24]

2.27 Rice Warner recommended that 'the proposed changes be deferred until the later of the fund's next premium rate guarantee expiry and 1 July 2020'.[25] Likewise, the Australian Institute of Superannuation Trustees (AIST) supported implementation being 'deferred until the later of 1 July 2020 or from the end of insurance policies commenced prior to Budget night'.[26]

2.28 Alternatively, some submitters and witnesses argued for a staged implementation, beginning with the consolidation measures contained in Schedule 3 of the bill.

2.29 The AFA endorsed a staged approach to implementation, submitting that:

> This new regime is schemed to commence from 1 July 2019 and superannuation funds are expected to start communicating with members from as soon as April 2019. All these changes are proposed to start on the same day. There is no sensible transition plan. We believe that these reforms should be pursued in stages and that the first step should be to undertake the account consolidation activity.[27]

2.30 AIST suggested a phased approach to implementation would test the capability of both superannuation funds and the Australian Taxation Office (ATO) to effectively carry out the proposed changes:

> …in our submission we have suggested that there be a phased implementation of the changes, and in relation to the inactive low account balance measures we have suggested that there actually be a pilot take place during the course of the next 12 months. That's not an exceptional suggestion, because that tests fund capability and it tests ATO capability. It means that when full implementation takes place, all of the bugs have been worked out. It's an approach that was followed with SuperStream, with rollovers and then with contributions, and it's what's happening now with single touch payroll. A slow introduction of these measures we think is in the interests of the stability of the system and ultimately in the interests of members, because you don't want to be in a situation where ATO systems fall over because they were unable to cope with the volumes generated by these changes.[28]

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24 See, for example, Corporate Superannuation Association, *Submission 6*, pp. 4–5; MetLife Insurance Limited, *Submission 9*, p. 5 Australian Institute of Superannuation Trustees, *Submission 10*, p. 5.

25 Rice Warner, *Submission 7—Attachment 1*, p. 7.

26 Australian Institute of Superannuation Trustees, *Submission 10*, p. 5.

27 Association of Financial Advisers, *Submission 24*, p. 11.

28 Mr David Haynes, Senior Policy Manager, Australian Institute of Superannuation Trustees, *Committee Hansard*, 20 July 2018, p. 57.

2.31 Representatives from APRA told the committee that there is merit in a staged approach to implementation, noting that the consolidation of low-balance, inactive accounts by the ATO, provided for in Schedule 3 of the bill, would help to address the issue of duplicated accounts:

> We do think, as Helen pointed out earlier, there is merit in the low account balance consolidation as a first measure, because that in fact tidies up a lot of the duplication, and then then you would come back and, as a second stage approach to the insurance, you would be effectively doing it with a smaller cohort than you would if you did it at the same time that you were doing the account consolidation.[29]

2.32 In contrast to those views above, Professor John Daley, CEO of the Grattan Institute, argued that the timeframe for implementation, while not a long time, 'is perfectly doable'. Illustrating this point, Professor Daley drew the committee's attention to previous significant legislative changes implemented by the superannuation industry:

> A number of the submissions have pointed out that 11 months seems quite tight for these changes, but can I suggest that in terms of a corporate making arrangements of this kind, where the big question is essentially going to be getting all of the underwriting correct and getting the processes in place, 11 months is not a long time but is perfectly doable. To illustrate how doable that is, back in 2012 parliament passed the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act…That bill provided that it was a requirement going forward that anyone offering default super must provide default insurance, which up until then had not been a compulsory feature of the superannuation scheme. That act was required to come into force a mere seven months later, on 1 July 2013. The industry it appears had no trouble in complying with an act that increased its revenue over a seven-month period.[30]

Definition of 'inactive'

2.33 The bill inserts a definition of 'inactive' into the *Superannuation Industry (Supervision) Act 1993* (SIS Act). A choice or MySuper product will be considered inactive if no contributions or rollovers have been received in the previous continuous period of 13 months. The period of inactivity is reset when a contribution or rollover is received; that is, the contribution or rollover resets the clock on inactivity for another 13 months.[31]

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29 Mr Geoff Summerhayes, Member, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 4.

30 Professor John Daley, Chief Executive Officer, Grattan Institute, *Committee Hansard*, 20 July 2018, p. 87.

31 *Explanatory Memorandum*, p. 21.

2.34 The definition of inactive is relevant to the application of measures in both Schedule 2 and Schedule 3 of the bill, specifically:

- Schedule 2 to the bill prevents trustees from providing opt out insurance to members with inactive MySuper or choice accounts, unless a member has directed otherwise.
- Schedule 3 to the bill requires the transfer of all superannuation accounts with balances below $6,000 to the Commissioner of Taxation (Commissioner), if the account has been inactive for a continuous period of 13 months.[32]

2.35 Inquiry participants had differing views with regard to the appropriateness of what constitutes an 'inactive' account as defined by the bill. Some submitters and witnesses disagreed with the 13-month period of inactivity, and argued that this should be extended. The committee also heard evidence from a number of inquiry participants that the definition of inactive should be amended to include additional circumstances that demonstrate a member's engagement with their account.

Period of inactivity

2.36 In relation to the consolidation measures in Schedule 3 of the bill, the Association of Superannuation Funds of Australia (ASFA) took the view that 13 months without any contributions 'is a relatively short timeframe for the determination of inactivity'. ASFA reasoned that 'a member may have perfectly straightforward reasons for such inactivity including maternity leave, carers' leave and extended leave for travel or study'. ASFA further contended that the 13-month timeframe of inactivity for account consolidation should be extended to two years as this 'would provide greater assurance that the member is genuinely lost or disengaged'.[33]

2.37 Link Group expressed a similar view, submitting that 'a 13-month period of inactivity does not necessarily equate to members' disinterest or lack of awareness of accounts' and that such inactivity 'may be caused by a number of reasons'.[34]

2.38 Although its current internal policy definition of account inactivity is 13 months without a contribution, AustralianSuper also supported an extended timeframe of inactivity, suggesting that a period of 16 months would be more appropriate. AustralianSuper submitted that:

> …the period of inactivity should cover 16 months instead of 13 months to more appropriately cover workers who have undertaken parental leave. Parents will typically recommence work after their paternal leave and wait up to three months for their superannuation contributions to reach their superannuation account, as the obligation to contribute Superannuation Guarantee contributions is quarterly. The period of inactivity needs to factor in this additional three month period because otherwise their

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32 *Explanatory Memorandum*, pp. 7–8.

33 Association of Superannuation Funds of Australia, *Submission 12*, p. 8.

34 Link Group, *Submission 27*, p. 2.

> superannuation will be transferred to the ATO when they have recommenced employment and superannuation contribution activity.[35]

2.39 Similarly, Mr Geoff Burgess, Deputy Chairman of the Corporate Superannuation Association, suggested that a 13-month period may not adequately capture women on maternity leave:

> I think we'd support extending that 13 months, preferably to something like two years. Women on maternity leave are the classic example. They might take 12 months unpaid maternity leave, their employer has three months to pay the next lot of contributions—suddenly, you're up to 15 months. And it doesn't take much to get beyond the 15 months: they may take not 12 months but 12½ months—all sorts of things. So I think somewhere around 18 months, preferably two years, would be a better measure for that purpose.[36]

2.40 Industry Super Australia (ISA) proposed that the period of inactivity, as defined by the bill, be extended from 13 to 16 months. In giving evidence to the committee, Mr Matthew Linden, Director of Public Affairs at ISA, explained that:

> Based on feedback from some of our funds, in many respects this reflects some of the issues with the current quarterly regime with the superannuation guarantee, where there might be a lag of three to four months between when a person is returning to work, when they are eligible for a superannuation guarantee contribution, and when it must be paid to that employee under the Superannuation Guarantee (Administration) Act. There can be a lag of up to three months and 28 days.[37]

2.41 Mr Linden also commented on the potential benefits of a longer inactivity timeframe for individuals who are self-employed and whose superannuation contributions are often more episodic:

> We think increasing the time period where eligible contribution would define someone as inactive or not is an important change which would need to be made to reduce the risk for someone who indeed may well be working. For someone who's self-employed and working, they might during that portion of time be responsible for their own super contributions. They might not make them. It will give them a bit more leeway in terms of making that contribution and not being in a situation where they might lose important default cover.[38]

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35 AustralianSuper, *Submission 23*, p. 2. See also, Australian Institute of Superannuation Trustees, *Submission 10*, p. 4.

36 Mr Geoff Burgess, Deputy Chairman, Corporate Superannuation Association Inc, *Committee Hansard*, 20 July 2018, p. 22.

37 Mr Matthew Linden, Director, Public Affairs, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 71.

38 Mr Matthew Linden, Director, Public Affairs, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 72.

2.42 The AFA recommended that the timeframe of inactivity for the transfer of an account to the ATO should be extended to 18 or 24 months as this would 'reduce the number of people who have their funds move to the ATO against their wishes'. The AFA also commented that:

> Some consideration needs to be given to the cost and disruption involved in the transfer to the ATO and the recovery. The benefits of moving it sooner do not seem to justify the potential inconvenience and wasted administration.[39]

2.43 In contrast, Maurice Blackburn Lawyers agreed that 13 months is an appropriate threshold for determining inactivity. Maurice Blackburn submitted that '[i]n our experience, lessor periods of inactivity are often due to parental leave considerations or other life circumstances'.[40]

2.44 Mr Xavier O'Halloran, Campaigns and Policy Team Lead at CHOICE, was supportive of the 13-month period of inactivity in the bill. Mr O'Halloran was of the view that a 13-month period of inactivity would appropriately 'pick out the vast majority of people', and informed the committee that:

> This is one of the bigger debates that happened in the life insurance code process and the 13-month figure was something that was a compromise after the evidence that we presented showed that average maternity leave times were closer to seven months or even lower in some circumstances. Taking into account all the different factors such as delays in super guarantee payments, a period of inactivity 13 months would pick out the vast majority of people. On top of that, there is contemplated a disclosure regime so that people will be informed that they may lose insurance and have the opportunity to keep it going. There were so many protections and extended timeframes built into that 13-month figure already that it's interesting that industry is now coming back and saying that to protect that demographic they need even longer.[41]

2.45 Grattan noted the arguments for an extended timeframe for which an account is to be considered inactive in its submission, and contended that the cut-off 'is ultimately a question of degree':

> On the one hand, if accounts are consolidated later, there will be fewer instances of a person returning to the workforce. On the other hand, if accounts are consolidated earlier, many people who have in fact changed jobs will benefit.[42]

39 Association of Financial Advisers, *Submission 24*, p. 9.

40 Maurice Blackburn Lawyers, *Submission 3*, p. 3.

41 Mr Xavier O'Halloran, Campaigns and Policy Team Lead, CHOICE, *Committee Hansard*, 20 July 2018, p. 12.

42 Grattan Institute, *Submission 33*, p. 7.

2.46 Mr Nick Kirwan, Senior Policy Manager (Life Insurance) at the FSC, shared a similar view:

> The difficulty here is it's actually balancing two evils. If someone has changed jobs and has got their insurance in a different superannuation scheme, then 13 months is perhaps too long, when 13 minutes would probably be about right in those circumstances. But equally there are people for whom 13 months is clearly too short…So 13 months is a trade-off. It's probably wrong for everyone. For some people it should be longer and for some people it should be shorter. But in setting a rule, of course, you have to draw that trade-off. It's probably about right.[43]

Additional circumstances demonstrating account engagement

2.47 In addition to extending the 13-month inactivity timeframe, ISA advocated for a broader definition of what constitutes member engagement with an account. ISA submitted that '[a]n account ought to be considered active in circumstances where it can be clearly demonstrated that the account holder has intentionally engaged with the account'.[44] Elaborating on this point, ISA argued:

> Circumstances where an account should be considered active include actions taken by the member such as investment option switching; nominating or changing binding nominations for account beneficiaries; increasing or decreasing insurance cover; where an income stream is being deducted from the account or where the member has expressly opted to remain with the fund.[45]

2.48 Similarly, Cbus Super recommended that:

> …the definition of inactive should be clearly defined, practical and contemplate different workforce patterns/scenarios such as seasonal workers and parental leave. For example, inactivity could be where there is no contribution or other prescribed form of member engagement (some positive act indicating the member wishes to remain a member of the fund).[46]

2.49 The Australian Council of Trade Unions (ACTU) also contended that 13 months without a contribution by itself does not adequately reflect a member's engagement with their account. Mr Joseph Mitchell, Workers' Capital Organising Officer, ACTU, called for 'a more nuanced definition of an inactive account':

> If someone takes an extended time off and they have done the due diligence of changing their beneficiaries or changing their investment portfolios or having meaningful interactions with the fund—and I stress 'meaningful'—

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43 Mr Nick Kirwan, Senior Policy Manager (Life Insurance), Financial Services Council, *Committee Hansard*, 20 July 2018, pp. 36–37.

44 Industry Super Australia, *Submission 26*, p. 14.

45 Industry Super Australia, *Submission 26*, p. 14. See also Mr Matthew Linden, Director, Public Affairs, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 72.

46 Cbus Super, *Submission 32*, pp. 13–14.

> then that person is an active holder of that account. They know that that account is there, regardless of whether it's receiving contributions.[47]

2.50 When questioned by the committee about whether the inclusion of additional circumstances of member engagement with an account had been considered in developing the definition of inactivity in the bill, representatives from The Treasury advised the committee:

> We are aware of these proposals, because they've been brought up with us. We've taken the view that there should be a rigorous definition of activity…In some ways, if people aren't receiving contributions, there's a good chance they're not working, in which case they might not be covered anyway, or they've got another job and their contributions are going elsewhere, and so there's a risk of duplicate accounts. That's the problem we're trying to solve.[48]

Views on Schedule 1—Fees charged to superannuation members

2.51 Schedule 1 to the bill prevents superannuation trustees from charging certain fees or costs—administration fees, investment fees and prescribed costs—that exceed three per cent of the balance of an account annually if the balance is less than $6000 at the end of a fund's income year or at the time of account closure.[49] The fee cap percentage can be no more than three per cent and will be set in regulations.[50]

2.52 Prescribed costs refer to an amount prescribed in regulations that are incurred by a trustee for the administration of the fund or investment in the fund's assets which are not charged to the member as a fee. It is expected that the regulations will capture amounts which directly or indirectly reduce the return on a member's investment.[51]

2.53 Schedule 1 to the bill also prevents trustees from charging exit fees, other than a buy-sell spread, that relate to the disposal of all or part of a member's interest in a fund, regardless of a member's account balance.[52]

General comments on Schedule 1

2.54 Most inquiry participants were broadly supportive of the fee cap and exit fee measures in Schedule 1 of the bill.[53]

47 Mr Joseph Mitchell, Workers' Capital Organising Officer, Australian Council of Trade Unions, *Committee Hansard*, 20 July 2018, p. 43.

48 Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, The Treasury, *Committee Hansard*, 20 July 2018, p. 92.

49 *Explanatory Memorandum*, pp. 9–10.

50 *Explanatory Memorandum*, p. 11.

51 *Explanatory Memorandum*, p. 11.

52 *Explanatory Memorandum*, pp. 9–10 and pp. 15–16.

53 See, for example, CHOICE, *Submission 15*, p. 6; Australian Council of Trade Unions, *Submission 16*, p. 5; AustralianSuper, *Submission 23*, p. 2; COTA Australia, *Submission 30*, p. 2.

2.55 In expressing its support for the proposed fee cap, FCA submitted that '[t]he legislative intent of the superannuation system is for people to grow their retirement savings over time. Superannuation that is eroded by fees defeats that legislative intent'. FCA was supportive of the proposed ban on exit fees, submitting that:

> Exit fees stop people from rolling over their superannuation to a better performing superannuation fund and therefore reduce competition. Exit fees stop people from effectively managing their superannuation and improving financial literacy by being able to shop around without penalty.[54]

2.56 Mr O'Halloran from CHOICE agreed that a ban on exit fees will empower Australians to shop around and switch if they are unhappy with their superannuation arrangements:

> Yes, I think it will. When we've done surveys on consumers around superannuation we've found that exit fees are a barrier. When we've reviewed them we've found not all of them [exit fees] are exceptionally high, but it can be a mental barrier to a lot of people switching, even if the benefits of switching may eventually outweigh those fees. So I think it's a good practical measure that actually pays regard to how people think about switching and acts on the kinds of behavioural biases that they might display in considering to switch.[55]

2.57 COTA Australia welcomed the fee cap measure in the bill 'given that low-balance accounts currently pay disproportionally high fees leading to significant erosion of account balances'. COTA Australia further submitted that, combined with the proposed ATO powers, 'the measures will ensure that overall retirement balances are increased within consolidated superannuation accounts'.[56]

2.58 Grattan described the fee cap and exit fee measures as being 'sensible reforms', further contending that:

> The current arrangements create incentives for funds to encourage a multiplicity of small accounts, each paying a minimum fee. Inevitably this increases the total costs of the industry.
>
> The proposed fee caps will align the incentives for funds more closely with the interests of their members. The caps will encourage funds to seek out small accounts and ensure they either grow quickly, or are consolidated.[57]

2.59 ISA was welcoming of the proposed introduction of fee caps for low-balance accounts on direct and indirect fees, however cautioned against capping indirect fees 'without appropriate measures in place to ensure they apply consistently and transparently'.[58] ISA also submitted that 'without the opportunity to review the

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54 Financial Counselling Australia, *Submission 29*, p. 2.

55 Mr Xavier O'Halloran, Campaigns and Policy Team Lead, CHOICE, *Committee Hansard*, 20 July 2018, p. 9.

56 COTA Australia, *Submission 30*, p. 2.

57 Grattan Institute, *Submission 33*, p. 8. See also Professor John Daley, Chief Executive Officer, Grattan Institute, *Committee Hansard*, 20 July 2018, p. 87.

58 Industry Super Australia, *Submission 26*, p. 5.

supporting regulation, the reforms may be subject to gaming and may not result in an equitable outcome for members'.[59]

2.60 The AFA commented on the implications that capping fees for low-balance accounts and banning exit fees will have for superannuation funds. The AFA noted that '[t]his will have a much greater impact on superannuation funds with members who are on low incomes, have low balances and change jobs more often', and that such funds 'will be at a substantial disadvantage to other funds'.[60]

Higher fees for other members

2.61 Some inquiry participants expressed concern that, given superannuation funds' fixed costs, members who are not impacted by the proposed fee changes in the bill will have to pay more.[61]

2.62 For example, Rest submitted that:

> The $26-million cost of the fee relief provided to Rest members with balances of $6,000 or less will be unfairly borne by the remainder of our 1.9 million members, many of whom have account balances only marginally above the $6,000 limit.
>
> In addition, these members will be charged higher fees and receive no additional benefit for services others receive at a discount, leading to potential confusion and resentment.[62]

2.63 With regard to the proposed ban on exit fees, the AFA argued that members who choose to leave a fund 'should be required to pay, as a minimum, the direct costs of processing that exit'.[63] The AFA reasoned that:

> The removal of any ability to charge an exit fee will mean that those members who remain loyal to the fund will need to subsidise the costs that result from the administration activity involved in processing withdrawals for those members who choose to leave the fund. On any measure, this is unreasonable for those who remain in the fund. For anyone who is a member of a high turnover fund, then this would be completely unreasonable.[64]

2.64 Chartered Accountants Australia and New Zealand (CAANZ) contended that implementation of the fee measures proposed in the bill would in fact promote

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59 Industry Super Australia, *Submission 26*, p. 3.

60 Association of Financial Advisers, *Submission 24*, p. 2.

61 See, for example, Australian Institute of Superannuation Trustees, *Submission 10*, p. 2; Chartered Accountants Australia and New Zealand, *Submission 8*, p. 2; Association of Financial Advisers, *Submission 24*, p. 5.

62 Rest, *Submission 22*, p. 9. See also Ms Vicki Doyle, Chief Executive Officer, Rest, *Committee Hansard*, 20 July 2018, p. 77.

63 Association of Financial Advisers, *Submission 24*, p. 5.

64 Association of Financial Advisers, *Submission 24*, p. 5.

superannuation trustees breaching their fiduciary duties, legislated under the SIS Act, to act in the best interests of and fairly between all beneficiaries.[65]

2.65 CAANZ further submitted that:

> …to effectively implement the government's proposed policy, trustees will need to charge higher fees to those with account balances of at least $6,000.
>
> In effect, this would mean that a super fund trustee would not be acting fairly between all beneficiaries and this issue would exist despite the protections proposed in sub-section 99G(7) of the SIS Act as contained in the bill.[66]

2.66 Mrs Rowell, Deputy Chair of APRA, acknowledged in her opening statement to the committee that the fee changes proposed in the bill are likely to require a review of fee structures by superannuation funds and, consequently, may lead to higher fees for members with account balances over $6000.[67]

2.67 Mr Burgess from the Corporate Superannuation Association, suggested that, where a member removes the entirety of their balance from a fund for consolidation purposes, the small exit fee cross-subsidy borne by other members is balanced with the member benefit obtained through account consolidation. However, Mr Burgess argued that this exit fee cross-subsidy is not appropriate for partial account withdrawals, only full withdrawals.[68]

Concern that measures could be gamed

2.68 A number of submitters and witnesses highlighted the potential for the proposed fee cap and ban on exit fees to be gamed as a matter of concern. In particular, inquiry participants pointed to inconsistencies between what is classified as 'fees' and 'indirect costs'; the exclusion of buy-sell spreads; and the possibility of members moving funds from their account prior to balance test day as avenues for funds to game the fee cap and exit fee measures.

Transfer to indirect fees and costs

2.69 AIST expressed concern in its submission that inconsistencies in how fees and indirect costs are classified 'provides an avenue for entities to game the fee capping requirements'. Accordingly, AIST indicated it was pleased that the explanatory materials for the bill refer to indirect costs being included in the fee cap calculation.[69]

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65 Chartered Accountants Australia and New Zealand, *Submission 8*, p. 2.

66 Chartered Accountants Australia and New Zealand, *Submission 8*, p. 2.

67 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 1.

68 Mr Geoff Burgess, Deputy Chairman, Corporate Superannuation Association Inc, *Committee Hansard*, 20 July 2018, p. 19. See also Corporate Superannuation Association, *Submission 6*, p. 4.

69 Australian Institute of Superannuation Trustees, *Submission 10*, p. 1.

2.70 Mr David Haynes, Senior Policy Manager at AIST, elaborated on this point in giving evidence to the committee:

> …we believe that there are a significant number of ways in which people can manipulate the operation of a fee so that things that are fees are redefined as not being a fee. We think the most significant example of that is in relation to indirect costs. So, while that's not the whole universe of issues, our argument is that indirect costs should be clearly and consistently identified and included within the definition for the fees and the fee cap for the purposes of this legislation…[70]

2.71 While supportive of the proposed fee cap and the inclusion of indirect fees and costs in the calculation of the fee cap, Mr Alan Kirkland, CEO of CHOICE, pointed to the need for closer oversight of attempts to game the cap:

> …regulation of fees is a very complex thing. It can be a noble but complex objective to execute. So we need to be careful of things like hidden fees and costs that might get around the fee cap. We need to make sure there's appropriate monitoring to try and pick up on any of those consequences.[71]

2.72 Similarly, Mr Linden from ISA commented on the issue of clarity around indirect costs:

> You have a situation where some funds may charge fees directly. In the case of others, there might be indirect costs which are incurred which equally reduce balances but that may not be explicitly levied as a fee by the RSE. So our view is that it should be consistent and comprehensive.[72]

2.73 Mr Linden acknowledged that the bill contains a regulation-making power to define indirect costs that will be captured by the proposed fee cap.[73]

Exclusion of buy-sell spreads

2.74 As noted above, the bill excludes buy-sell spreads—the transaction cost incurred by a trustee of a superannuation entity when they buy or sell the assets of the entity—from the proposed ban on exit fees.

2.75 Cbus Super queried the exclusion of buy-sell spreads from exit fee measure in the bill, and strongly submitted that the ban on exit fees must 'also extend to buy-sell spreads if it is to be effective'. Cbus Super contended that:

> …failing to tackle buy-sell spreads will result in the exit fee ban being able to be gamed by funds imposing buy-sell spreads as a disincentive for

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70 Mr David Haynes, Senior Policy Manager, Australian Institute of Superannuation Trustees, *Committee Hansard*, 20 July 2018, p. 58. See also Mr Geoff Burgess, Deputy Chairman, Corporate Superannuation Association Inc, *Committee Hansard*, 20 July 2018, p. 19.

71 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 20 July 2018, p. 8. See also CHOICE, *Submission 10*, pp. 5–6.

72 Mr Matthew Linden, Director, Public Affairs, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 70. See also Industry Super Australia, *Submission 26*, p. 4.

73 Mr Matthew Linden, Director, Public Affairs, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 70.

members to exit. Buy-sell spreads are less transparent than exit fees and are often more detrimental to members transacting in or out of funds.[74]

2.76 Ms Louise du Pre-Alba, Strategic Policy Advocate at AustralianSuper, expressed a similar view:

> …our concern is that exit fees are subject to certain requirements around being limited to cost recovery. Buy-sell spreads currently are not limited by cost recovery. So, while we can give you information on what buy-sell spreads typically look like now, if they're not limited by things like cost recovery requirements then they could proliferate. They could also proliferate because they're less prominent in a member's decision-making process when looking at fees and fee comparisons.[75]

2.77 CHOICE also expressed concern that some providers may seek to game the prohibition of exit fees by increasing other fees charged on exit, such as buy-sell spreads. CHOICE characterised buy-sell spreads as being 'extremely opaque', submitting that:

> Often the exact buy-sell spread is not known and therefore not disclosed in a product disclosure statement; a person is instead left with a percentage-based range they may be charged on exit. It is unlikely most consumers have any understanding of what the term buy-sell spread means, let alone the circumstances in which it will be charged.[76]

Withdrawing funds prior to balance day

2.78 The proposed fee cap for low-balance accounts is calculated based on a member's account balance on the last day of a fund's income year or at the time of account closure.[77]

2.79 ASFA submitted that the annual balance test for the purpose of calculating the fee cap could have unintended consequences or be used to minimise fees. ASFA further observed that the balance day test 'does not appear to allow for the possibility of the account having had a higher balance in the previous 12 months'.[78]

2.80 ASFA recommended that:

> [T]he 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.[79]

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74 Cbus Super, *Submission 32*, p. 17.

75 Ms Louise du Pre-Alba, Strategic Policy Advocate, AustralianSuper, *Committee Hansard*, 20 July 2018, p. 76.

76 CHOICE, *Submission 15*, pp. 6–7.

77 *Explanatory Memorandum*, pp. 10–11.

78 Association of Superannuation Funds of Australia, *Submission 12*, p. 5. See also Mercer, *Submission 19*, p. 7.

79 Association of Superannuation Funds of Australia, *Submission 12*, p. 6. See also Australian Institute of Superannuation Trustees, *Submission 10*, p. 2.

2.81 The Law Council of Australia also expressed concern that the fee cap measure as proposed in the bill could be 'open to abuse', whereby a member temporarily rolls out most of their account balance immediately prior to the balance test day, and suggested that some modification be made to address the potential for arbitrage.[80]

2.82 QSuper also highlighted this as a concern and provided the following example:

> …a member with a $1 million balance could reduce their balance to $100 the day before the calculation is performed. A member's balance in a product could reduce because they have withdrawn funds, rolled funds over to another fund, or moved funds to another product, such as a pension product.
>
> In this situation, the fund would be required to refund the fees in excess of fees calculated on a $100 balance and not the member's balance throughout the year. This could potentially be used annually by members to rollover funds in the last week of the year to avoid paying fees.[81]

2.83 Professor Daley from the Grattan Institute advised the committee that he does not share the concerns raised by some stakeholders regarding the potential for the fee cap and exit fee measures in the bill to be gamed. Professor Daley explained that:

> The reason I don't share those concerns is that I'm guessing the number of actual individuals who will try and game the system in that way is going to be small in the overall scheme of things. It might well be that we can come up with these examples, but my guess is that, in practice, most people are simply going to toll their money from one account to another rather than mucking around.[82]

Views on Schedule 2—Insurance for superannuation members

2.84 Schedule 2 to the bill will prevent trustees from providing insurance cover on an opt out basis to a member of a MySuper or choice superannuation account 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.[83]

2.85 A superannuation trustee may only provide insurance to a member who meets one of the criteria above where the member has elected to obtain or maintain the insurance cover.[84]

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80 Law Council of Australia, *Submission 20*, p. 2.

81 QSuper, *Submission 18*, p. 1.

82 Professor John Daley, Chief Executive Officer, Grattan Institute, *Committee Hansard*, 20 July 2018, p. 88.

83 *Explanatory Memorandum*, pp. 17–19.

84 *Explanatory Memorandum*, p. 19.

General support for the intent of insurance measures

2.86 Most submitters and witnesses noted their support for the intent of the measures proposed in Schedule 2 of the bill; that is, the protection of Australians' retirement savings from undue erosion resulting from inappropriate and, in some cases, duplicate insurance premiums.

2.87 For example, CHOICE submitted that it supports the overall intent of the insurance measures in the bill, commenting that:

> There are clear and strong reasons for making insurance opt in for people under 25 years of age, low income people and those with inactive accounts. The estimated $3 billion savings to these people of the reform will help people save for retirement with dignity.[85]

2.88 Similarly, ClearView Wealth expressed the view that:

> Requiring young Australians and those with low account balances to consciously opt-in for life insurance inside super is sensible public policy that will go some way to protecting members and ensuring savings are not eroded by premiums on life insurance they often do not need and commonly cannot even claim on.[86]

2.89 ClearView Wealth further submitted that:

> …a system which requires members to consciously opt in for group insurance in super will result in a substantial improvement in understanding what they are, and aren't, covered for and how much cover they have. This will significantly reduce the number of workers who think they, and their loved ones, are adequately protected when they're not. Importantly it will lead to more workers seeking advice, either via their super fund or a third party, about the type, and level, of cover they need.
>
> …
>
> An opt in model will also force many of the current inherent cross-subsidies to be addressed and help make transparent what the real costs of the current system are.[87]

2.90 FCA acknowledged that insurance in superannuation can be a low-cost way for people to get access to life insurance, but contended that 'there is no doubt that insurance premiums erode low balances in superannuation accounts'. FCA also commented that:

> FCA is concerned that many people may be paying insurance premiums for insurance that they can never claim on, or is of little, or no value. It is also possible because of lost super and external insurance sales that many people are double insured.

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85 CHOICE, *Submission 15*, p. 10.

86 ClearView Wealth, *Submission 2*, p. 6. See also Mr Simon Swanson, Managing Director, ClearView Wealth, *Committee Hansard*, 20 July 2018, p. 30.

87 ClearView Wealth, *Submission 2*, p. 6. See also Dixon Advisory, *Submission 4*, p. 2.

> …
>
> We appreciate that superannuation funds provide insurance as a safety net for their members but it should not be at the cost of people having suitable insurance or significantly impacting their retirement savings.[88]

2.91 However, while generally supportive of the intent behind the insurance measures in the bill, other inquiry participants were less supportive of the legislative approach proposed in the bill. The main concerns raised by stakeholders are summarised below.

Insurance premium increases and long term impacts

2.92 The matter of premium increases resulting from the proposed changes to default group insurance arrangements was raised as a common concern during the inquiry.

2.93 Submitters and witnesses highlighted that premiums for members not impacted by the insurance measures will increase due to the fixed costs associated with default group insurance and changes to the demographics of the collective risk pool of insured members. Inquiry participants also emphasised the likely premium increases and changes to automatic acceptance terms for members who choose to opt in to insurance coverage following implementation of the proposed changes, attributing such increases to a need for individual underwriting and the risk of anti-selection associated with providing cover on an opt in basis.[89]

2.94 Mercer summarised this concern, submitting that:

> Increases in premium rates and changes to automatic acceptance terms are highly likely as a result of greater expected anti-selection (e.g. opt-in is more likely for members in poorer health), more underwriting costs and the spreading of fixed costs over a smaller premium base.[90]

2.95 Similarly, CAANZ observed that the group insurance model that currently applies to most superannuation fund members means that insurers cannot be 'selected against'. CAANZ continued that '[a]ny ability to allow a super fund member to self-select their participation in the arrangement alters the contract dynamics and therefore pricing that insurers are willing to offer'.[91]

2.96 In response to questions taken on notice, The Treasury have indicated that the increase in premiums that remaining members in the pool might face will be reflective

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88 Financial Counselling Australia, *Submission 29*, p. 3.

89 See, for example, Cbus Super, *Submission 32*, p. 12; Association of Financial Advisers, *Submission 24*, p. 6; Industry Super Australia, *Submission 26*, p. 12; RGA Reinsurance Company of Australia Limited, *Submission 14*, p. 2; AIA Australia, *Submission 17*, p. 15.

90 Mercer, *Submission 19*, p. 9. See also, Mr Vincent Watt, Acting Chief Executive Officer, MetLife Insurance Limited, *Committee Hansard*, 20 July 2018, p. 66.

91 Chartered Accountants Australia and New Zealand, *Submission 8*, p. 3.

of the risk those members (older, sicker and higher balance members) bring into the pool.[92]

2.97 AIAA also contended that a reduction in insurance for young Australians would increase premiums for remaining members, reasoning that 'removing under 25s would change the demographics of the risk pool and the underlying principle of group insurance through the distribution of risk'.[93]

2.98 The AFA argued that the insurance changes in the bill fail 'to take into consideration that if you take a large number of people out of the insurance pool then it increases the cost for everyone left in the pool'. The AFA continued that:

> This is due to the fact that the fixed costs of the insurance business need to be apportioned over a lesser number of members and also those removed from the pool might represent lower risks. In fact, the impact is compounded by the reality that those who choose to opt-in are more likely to be the people who are at increased risk of making a claim.[94]

2.99 ISA also considered the principle of collective risk-pooling in group insurance in its submission:

> Insurance in superannuation is a highly cost-effective mechanism that provides an additional safety net to millions of Australians and their families, and it plays a significant role in reducing Australia's estimated level of underinsurance. This is principally achieved through the effects of collective risk-pooling. Trustees can negotiate rates that are lower at a group level than if each member was individually underwritten. Through default enrolment, members benefit from group underwriting and the risk is more evenly shared amongst the insured. However, if new members are not automatically enrolled upon joining a fund and must opt-in, they will be subject to individual underwriting and higher premiums putting these members at an unnecessary disadvantage.[95]

2.100 The Explanatory Memorandum for the bill acknowledges that members that continue to hold default insurance in superannuation may also face increased premiums, however also notes that any increase due to a change in risk profile would reflect an unwinding of cross-subsidisation across cohorts.[96]

2.101 Mr Allan Hansell, Director of Policy and Global Markets at the FSC, acknowledged that cross-subsidisation occurs between younger and older members of a fund, but suggested that this is an inherent part of the risk-pooling that takes place under group insurance arrangements:

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92 The Treasury, answers to questions on notice, 20 July 2018, (received 3 August 2018).

93 AIA Australia, *Submission 17*, p. 15.

94 Association of Financial Advisers, *Submission 24*, p. 6.

95 Industry Super Australia, *Submission 26*, p. 12. See also, Mr Brett Clark, Group CEO and Managing Director, TAL Life Limited, *Committee Hansard*, 20 July 2018, p. 65.

96 *Explanatory Memorandum*, p. 52.

> People talk a lot about cross-subsidisation between the various age cohorts. But if you look at a person, they will commence in an insurance scheme as a younger member, and, yes, there will be a level of cross-subsidisation that occurs between them and older people, and the sick; but then, as they move through the life cycle, they end up getting the same level of support from younger members at a future date, because they remain as a member of the scheme. The whole concept of pooling is cross-subsidisation. Members put money into the insurance pool to cover off their risks, and when their health is compromised or they suffer from an illness, they draw down on the risk pool. If someone's healthy, then that's great, but they've got that insurance cover in place and they pay the premium for it.[97]

2.102 Analysis was undertaken for The Treasury by the Australian Government Actuary regarding the impact of the proposed changes in the bill on insurance premiums. The Government Actuary estimated that—following the cessation of default insurance cover for impacted members and opt in for those with balances below $6000 or inactive accounts—it is expected that insurance premiums will rise by seven to ten percent for accounts held by members over 25 years of age.[98]

2.103 In giving evidence to the committee, Mrs Rowell, Deputy Chair of APRA, recognised that the removal of certain cohorts from the insurance pool, in addition to the removal of inactive accounts, will likely create upward pressure on premiums for remaining insured members. However, Mrs Rowell also noted that '[t]he precise impact of the insurance proposals is difficult to assess at this time'.[99]

Rice Warner and KPMG Analyses

2.104 Throughout the inquiry, a number of inquiry participants pointed to research analyses carried out by KPMG and Rice Warner into the impact of the *Protecting Your Superannuation package*.[100]

2.105 The research by KPMG—*Insurance in superannuation: The impacts and unintended consequences of the proposed Federal Budget changes*—estimated that group life insurance premiums would increase by 26 per cent overall as a result of the insurance measures proposed in the bill.[101]

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97 Mr Allan Hansell, Director of Policy and Global Markets, Financial Services Council, *Committee Hansard*, 20 July 2018, p. 35.

98 Department of the Treasury, *Tabled Document 2*, May 2018, p. 4 (tabled 20 July 2018). See also Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, The Treasury, *Committee Hansard*, 20 July 2018, p. 90.

99 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 2.

100 See, for example, Association of Superannuation Funds of Australia, *Submission 12*, p. 4; AIA Australia, *Submission 17*, p. 12; Association of Financial Advisers, *Submission 24*, p. 8; Ms Jenni Baxter, Executive General Manager, Insurance, Rice Warner, *Committee Hansard*, 20 July 2018, p. 28.

101 KPMG, *Insurance in superannuation: The impacts and unintended consequences of the proposed Federal Budget changes*, June 2018, p. 4.

2.106 The research by Rice Warner (commissioned by AIAA)—*Economic Impact of 2018 Federal Budget Proposed Insurance Changes*—considered the longer term impacts on retirement balances as a result of default insurance being removed for members under 25 years of age. That research concluded that, if there is no change to insurance premiums as a result of the reforms, there would be a 0.76 per cent improvement in individuals' retirement balance. The research also modelled the impact of a premium increase of 15 per cent. In this case, the Rice Warner estimated that there would be an average improvement in individuals' retirement balance of 0.27 per cent.[102]

2.107 AIAA contended that the research by Rice Warner 'demonstrates that the benefits of removing default life insurance for under 25s would be minimal'.[103]

2.108 However, other inquiry participants questioned the validity of the above analyses. For example, COTA Australia noted that most of the premium increase estimated by KPMG is attributed to the removal of default group insurance for members with balances below $6000 or inactive accounts. COTA Australia submitted that:

> In other words, low balance account holders and inactive account holders are subsidising the overall premium pool, in most cases unwittingly.[104]

2.109 Grattan also pointed to the apparent cross-subsidy inherent in default group insurance, submitting that the KPMG and Rice Warner analyses strongly suggest that those cohorts impacted by the bill are cross-subsidising everyone else:

> The current system appears to have very substantial cross-subsidies. Analysis by both Rice Warner and KPMG in submissions to this Committee claim that the proposed changes to default insurance would lead to large increases in insurance premiums. This strongly suggests that those who are young, have inactive accounts, or small balances, are cross-subsidising everyone else. It is not obvious why it is desirable for there to be an insurance cross-subsidy for those who are old or have large balances.[105]

2.110 Mr Beckett from The Treasury also commented on the KPMG and Rice Warner research on the proposed *Protecting Your Superannuation package* reforms, noting that these analyses appear to use certain unrealistic assumptions:

> We're aware of some submissions to the committee which contend that there will be minimal improvements in people's ultimate retirement balances as a result of these changes. On this we would observe simply that the modelling in these analyses appears to use certain assumptions, including that individuals only ever have one job, one super account and

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102 Rice Warner, *Economic Impact of 2018 Federal Budget Proposed Insurance Changes*, May 2018, p. 16.

103 AIA Australia, *Submission 17*, p. 12.

104 COTA Australia, *Submission 30*, pp. 3–4.

105 Grattan Institute, *Submission 33*, p. 4.

> one set of insurance. This is unrealistic, but it's important to note that reforms intended to address more realistic scenarios still result in an improvement in retirement balances for these idealised scenarios. We know that people don't stay in one job for their working lives. Multiple super accounts resulting in duplicate insurance policies are very common and something that the PC is currently grappling with. Where a person has more than one account, which we know is the case for approximately 40 per cent of all superannuation members, the impact on their ultimate retirement balance is more pronounced as the changes will mean that these members will no longer pay for unnecessary duplicate insurance.[106]

Members in high-risk occupations

2.111 Several submitters and witnesses contended that the characteristics of certain cohorts of people warrant the exclusion from the insurance measures proposed in the bill; in particular, individuals who are employed in high-risk occupations. Inquiry participants argued that where such individuals choose to opt in for insurance coverage, insurers are likely to refuse cover or require individual underwriting. Where cover is offered, inquiry participants considered that cover is likely to be limited or expensive.[107]

2.112 For instance, ISA submitted that workers employed in high-risk occupations 'need the default insurance offered in superannuation from the day they start work'. ISA elaborated that:

> The risk of death or disability in high-risk work does not wait to materialise until a worker's super balance reaches the $6000 or they turn 25. Safe Work Australia data clearly demonstrates that some industries are more hazardous than others. A worker is 38 times more likely to die at work in the agriculture, forestry and fishing industries than the national average across all workplaces.[108]

2.113 AIAA argued that the insurance changes proposed in the bill could remove 'an important and necessary safety net' for young Australians:

> 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

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106 Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, The Treasury, *Committee Hansard*, 20 July 2018, p. 90.

107 See, for example, Australian Institute of Superannuation Trustees, *Submission 10*, pp. 3–4; Rice Warner, *Submission 7—Attachment 1*, p. 3; Maurice Blackburn Lawyers, *Submission 3*, p. 4; Maurice Blackburn Lawyers, *Submission 3*, p. 4; AIA Australia, *Submission 17*, p. 16; Cbus Super, *Submission 32*, p. 3–4.

108 Industry Super Australia, *Submission 26*, p. 8.

> the default model would leave these members exposed where there is some form of underwriting.[109]

2.114 Cbus Super submitted that the hazardous nature of work in high-risk industries will be problematic for impacted members who choose to opt in to insurance through superannuation:

> The policy assumptions which underpin the insurance measures in the Bill are that members excluded from default cover who wish to retain their cover will be able to opt in. However, given the hazardous nature of the industry in which our members work and the demographic of our membership, the impact of the reforms is far more problematic. There will be a proportion of members who will be refused cover or only provided limited cover, the conditions of acceptance of cover will be likely to be more restrictive for all members particularly in relation to pre-existing conditions, and the cost of coverage will increase for all members.[110]

2.115 A number of submitters and witnesses argued that an exemption to the proposed insurance measures be provided for members in high-risk occupations. Some suggested that this could be done via application to APRA.[111]

2.116 For example, ISA recommended that:

> Trustees ought to be able to apply to APRA to exempt certain cohorts of members from the prescribed insurance rules, where the trustee can demonstrate reasonable need to do so in order to protect the interests of its members.[112]

2.117 Cbus Super shared a similar view, submitting that:

> Should the Bill be supported for passage, we would strongly submit that a mechanism should be created to grant relief to funds like Cbus which offer default insurance coverage to higher risk member profiles who need, rely and claim against their cover. Such relief could be premised on the trustee obtaining independent actuarial certification of the hazardous nature of the industry and tailoring of product to reflect members' needs. These amendments would minimise unintended impacts on special categories of members who rely on default death and TPD and would be unable to obtain affordable opt-in insurance cover.[113]

2.118 APRA was cautious about suggestions for a mechanism whereby trustees could apply for exemptions for certain cohorts of members. Mrs Rowell, Deputy Chair of APRA, commented that:

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109 AIA Australia, *Submission 17*, p. 16.

110 Cbus Super, *Submission 32*, p. 9.

111 See, for example, Industry Super Australia, *Submission 26*, p. 12; Association of Superannuation Funds of Australia, *Submission 12*, p. 5; Corporate Superannuation Association, *Submission 6*, p. 3.

112 Industry Super Australia, *Submission 26*, p. 12.

113 Cbus Super, *Submission 32*, p. 13.

> Exemptions can be fraught with difficulties and can be abused, and so I think you'd want to think very carefully about how any exemptions would be framed and the criteria on which any exemptions would be based.[114]

2.119 Mr Kirkland from CHOICE expressed a similar view, stating that an exemption regime 'would need to be very tightly constrained, subject to strict criteria and quite robust evidence requirements'.[115] CHOICE also considered this point in its submission, commenting that:

> There is a risk that allowing carve outs may open the floodgates and undermine the intent of the legislation. If carve outs are contemplated a robust framework, including specific criteria and regulatory approval, should be in place to prevent misuse.[116]

2.120 Grattan took a different perspective from most submitters with regard to the issue of insurance for members in high-risk occupations. Grattan noted that workplace injuries will typically be covered by both workers' compensation schemes as well as insurance through superannuation. Grattan suggested that the problems faced by members in high-risk occupations in obtaining insurance:

> …could easily be remedied by writing insurance that did not cover incapacity covered by workers compensation. Those in high-risk industries are unlikely to have more illnesses or accidents outside of work. It is unlikely that the problems of adverse selection in this situation would be any greater than for workers in low risk industries.[117]

No default insurance for accounts under $6000

2.121 A number of inquiry participants expressed concern regarding the proposed changes to opt out default insurance cover for active accounts with balances less than $6000. Inquiry participants argued that this measure will disadvantage new members, particularly those who work part-time or are on lower incomes, in that they will be excluded from default insurance and the benefits it provides until their balance reaches $6000, despite receiving contributions.[118]

2.122 The FSC summarised this concern in its submission:

> By definition, new accounts start with a balance of zero, meaning that trustees would not be able to provide these members with default insurance

114 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 5.

115 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 20 July 2018, p. 8. See also CHOICE, *Submission 10*, p. 11.

116 CHOICE, *Submission 15*, p. 11.

117 Grattan Institute, *Submission 33*, p. 6. See also Professor John Daley, Chief Executive Officer, Grattan Institute, *Committee Hansard*, 20 July 2018, p. 86.

118 See, for example, Rice Warner, *Submission 7*, p. 1; MetLife Insurance Limited, *Submission 9*, p. 4; Australian Institute of Superannuation Trustees, *Submission 10*, p. 3; RGA Reinsurance Company of Australia Limited, *Submission 14*, p. 2; Australian Council of Trade Unions, *Submission 16*, p. 8; Maurice Blackburn Lawyers, *Submission 3*, p. 3.

> until their balance reaches $6,000. However, as soon as regular Superannuation Guarantee payments start, the account is clearly active.
>
> We do not understand the policy rationale for providing default insurance cover to people who are actively contributing to their accounts only when their balance reaches $6,000. Creating a lag in insurance cover for new members with active accounts appears to be an unintended consequence of the proposals.[119]

2.123 TAL expressed the view that removing opt out insurance coverage for balances under $6000 is not in the best interest of working Australians. TAL reasoned that:

> Under the proposed changes, an average working Australian will not be entitled to receive automatic default life insurance cover until they accumulate $6,000 as a superannuation balance, which could take up to 2–3 years depending on salary levels and superannuation contributions.
>
> Similarly, a member who is working but does not have $6,000 in their superannuation account will have their life insurance cover cancelled under the proposed changes.[120]

2.124 This view was supported by AIAA:

> 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.[121]

2.125 Several submitters argued that the removal of default life insurance cover for members with balances less than $6000 should only apply to inactive accounts.[122]

2.126 For example, Financial Rights and Consumer Action commented that:

> While we acknowledge the significant impact of balance erosion on low-balance accounts, we only support the move away from default insurance on accounts with balances under $6,000 for accounts which are inactive.
>
> …
>
> There are many reasons that a person may have a balance below $6,000. It may be because they have multiple accounts, recently returned after an extended period away from work, recently arrived in Australia, or their employer has not paid employer contributions. These could all occur with

119 Financial Services Council, *Submission 25*, pp. 2–3.

120 TAL Life Limited, *Submission 31*, p. 2.

121 AIA Australia, *Submission 17*, p. 9.

122 See, for example, Munich Reinsurance Company of Australasia Limited, *Submission 13*, p. 5; TAL Life Limited, *Submission 31*, p. 3; Financial Rights Legal Centre and Consumer Action Law Centre, *Submission 11*, p. 2; Financial Counselling Australia, *Submission 29*, pp. 3–4; Cbus Super, *Submission 32*, p. 13.

> active accounts. While insurance premiums will significantly erode low balances, it does not follow that people with low balances do not need insurance.[123]

2.127 Berrill & Watson shared this view, reasoning that 'whilst we agree that small accounts could be unnecessarily eroded by insurance premiums, this is really only true of inactive accounts'.[124] Elaborating on this point, Berrill & Watson submitted that:

> …active superannuation accounts fed by ongoing Superannuation Guarantee contributions will in all likelihood grow and not be eroded by insurance premiums to nil. If there are significant periods of inactivity, that would be protected by the triggering of the 13-month inactive account provision under section 68AAAA or perhaps by some lesser measure of inactivity on small accounts.
>
> Accordingly, we strongly endorse the recommendation of CALC and FRLC that section 68AAB should be amended to exempt active accounts under $6,000 from the removal of default insurance.[125]

Views on Schedule 3—Consolidation of inactive low-balance accounts

2.128 Schedule 3 to the bill amends the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (SUMLM Act) to include additional circumstances, namely when an account is inactive and has a balance of less than $6000, where the balance of an account must be transferred to the Commissioner.[126]

2.129 Schedule 3 to the bill also gives the Commissioner greater powers to consolidate amounts held for a person who has an active account, without needing to be directed to do so by the person and where the consolidated account balance will be $6000 or greater.[127]

General comments on Schedule 3

2.130 Most inquiry participants were broadly supportive of the consolidation measures in Schedule 3 of the bill.[128]

2.131 Maurice Blackburn Lawyers applauded the initiative, asserting that the expansion of the current provisions in the SUMLM Act for referring funds to the Commissioner 'seems like an appropriate way to enact this sensible move'.[129]

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123 Financial Rights Legal Centre and Consumer Action Law Centre, *Submission 11—Attachment 1*, p. 5.

124 Berrill & Watson, *Submission 5*, p. 2.

125 Berrill & Watson, *Submission 5*, p. 2.

126 *Explanatory Memorandum*, pp. 27–29.

127 *Explanatory Memorandum*, pp. 27–29.

128 See, for example, Chartered Accountants Australia and New Zealand, *Submission 8*, p. 4; Australian Institute of Superannuation Trustees, *Submission 10*, pp. 5–6; Financial Counselling Australia, *Submission 29*, p. 4.

129 Maurice Blackburn Lawyers, *Submission 3*, p. 5.

2.132 The SMSF Association (SMSFA) submitted that:

> The SMSFA supports the reunification of superannuation balances for individuals with inactive accounts below $6,000.[130]

2.133 CHOICE also noted its support for the consolidation provisions in the bill, observing that 'it will see billions of dollars flowing into the accounts of people'.[131]

2.134 Grattan described the proposed consolidation of inactive, low-balance accounts as 'a sensible reform that will substantially reduce the costs of administering and managing superannuation'.[132]

2.135 COTA Australia also expressed its full support, commenting that:

> These two initiatives will, hopefully, consolidated the 40% of superannuation accounts with balances below $6,000 and will increase the future balances members will have upon retirement age…The additional powers of the ATO Commissioner to consolidate low-balance superannuation savings held by the ATO into active superannuation accounts, without requiring consent of members, will improve consolidation of multiple funds held across the superannuation system.
>
> Given the increase in part-time jobs held by Australians, and the potential for numerous superannuation funds to be held in a member's name COTA Australia believes these measures should be supported to maximise the accumulation potential for members within the superannuation system.[133]

2.136 RGA Reinsurance Company of Australia (RGA) argued that account consolidation should be the focus of the *Protecting Your Superannuation package* as 'this will have the largest beneficial impact on future retirement savings'. RGA further noted that while consolidation will lead to a reduction in overall insurance cover, this 'will reflect the removal of multiple default insurance covers held by individuals, which in some cases are not wanted'.[134]

2.137 In contrast, Rest opposed the consolidation measures in the bill on the basis that:

> These members would lose valuable insurance cover.
>
> Members would receive investment returns based on the Consumer Price Index, rather than benefiting from the higher investment returns they would receive by remaining with their fund.

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130 SMSF Association, *Submission 28*, p. 3.

131 CHOICE, *Submission 15*, p. 17.

132 Grattan Institute, *Submission 33*, p. 7.

133 COTA Australia, *Submission 30*, p. 2.

134 RGA Reinsurance Company of Australia Limited, *Submission 14*, p. 1.

> Importantly we believe it is not necessary for the ATO to retain member's investments in order to reunite them with inactive accounts at a later date.[135]

Direct fund-to-fund transfer

2.138 A number of submitters and witnesses opposed the mechanism proposed in the bill by which inactive, low-balance accounts are transferred to a member's active account via the ATO, and argued that the ATO should not act as an intermediary in the account consolidation process. Some inquiry participants contended that it would be in members' best interests for account consolidation to instead occur by means of direct fund-to-fund transfer, reasoning that members would benefit from higher investment returns.[136]

2.139 For example, ISA argued that an approach whereby members' retirement savings are directed to an account where the net returns are greater than CPI would put members' interests first. ISA proposed an alternative direct fund-to-fund approach:

> The power to consolidate inactive accounts would remain in the hands of the Commission of Taxation and trustees would be required to report inactive accounts to the ATO. The proposed change would see no interference in the process of automatically consolidating a member's inactive account with an active account held by them - other than the inactive account funds would, in normal circumstances, continue to receive significantly higher net rates of return until they can be matched with an active account.
>
> When the ATO matches an inactive account with an active account, an order could be made for the immediate transfer of the monies held in the inactive account directly to the active account. This proposal would involve no delay in the transmission of funds. It would however, involve the accrual of significant funds into members' accounts. This simple proposal will directly benefit the retirement incomes of members and is in the public interest.[137]

2.140 Mr Haynes from AIST also advocated for a direct fund-to-fund approach, describing the method of account consolidation as proposed in the bill as 'double-handling'. Mr Haynes contended that by implementing direct fund-to-fund approach:

> …[y]ou would remove one step from that process, and it would be much less confusing for the consumer. It would mean that the member's superannuation interest would remain within the superannuation system the whole time. That would result in people's active accounts becoming

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135 Rest, *Submission 22*, p. 10. See also Ms Vicki Doyle, Chief Executive Officer, Rest, *Committee Hansard*, 20 July 2018, p. 78.

136 See, for example, Australian Institute of Superannuation Trustees, *Submission 10*, p. 6; Association of Superannuation Funds of Australia, *Submission 12*, p. 9; Mr Byron Addison, Senior Policy Adviser, Association of Superannuation Funds of Australia, *Committee Hansard*, 20 July 2018, p. 52.

137 Industry Super Australia, *Submission 26*, p. 15. See also Mr Richard Watts, Consultant, Industry Super Australia, *Committee Hansard*, 20 July 2018, p. 72.

> significantly bigger, and, again, as the committee knows, I think 40 per cent of people have more than one account. So it would actually result in a very significant uplift in people's active accounts about which they are more aware.[138]

2.141 Grattan expressed the view that stakeholder concerns regarding lower investment returns on accounts held by the ATO should be kept in perspective. Grattan submitted that, notwithstanding the fee cap measures for low-balance accounts proposed by the bill, the difference in returns between funds held by the ATO and those held in an inactive account 'is unlikely to be more than about $100 per year'. Grattan continued that:

> This may not be trivial to a person on a lower income, but a more complex administrative solution is unlikely to be worth pursuing given that the ATO will probably consolidate most accounts fairly quickly.[139]

2.142 While mindful of that leaving retirement savings in funds gives greater opportunity to earn higher investment returns, CHOICE noted its preference for an approach with greater ATO control. CHOICE also observed that 'given the ATO expects to be able to reunite most funds within a month these lost returns are likely to be small in quantum'.[140]

2.143 Professor Daley from the Grattan Institute shared the view that responsibility for administering account consolidation should remain with the ATO. Professor Daley reasoned that:

> I think the advantage of clearing money through the ATO is that it saves a lot of argy-bargy. If I can talk about a personal experience briefly, at one stage I tried to consolidate some money from an old super account into my current super account. I did that by writing to the existing super fund. First, there were a lot of forms to fill out. Second, it started to get quite complicated pretty quickly.
>
> …
>
> I think one of the problems with asking the super funds to talk to each other is that inevitably the donating super fund, if I can call it that, will rapidly try to contact the member and try to get them to change their mind. They will find reasons why the paperwork is not in order or that things haven't been spelt correctly, whereas if it's a message that's been passed to the ATO—and the ATO, of course, has automatically generated this because it can see the super balances and so on—then there's going to be a lot less argy-bargy.[141]

138 Mr David Haynes, Senior Policy Manager, Australian Institute of Superannuation Trustees, *Committee Hansard*, 20 July 2018, p. 56.

139 Grattan Institute, *Submission 33*, p. 8.

140 CHOICE, *Submission 15*, p. 18.

141 Professor John Daley, Chief Executive Officer, Grattan Institute, *Committee Hansard*, 20 July 2018, p. 88.

Exclusion where no active account

2.144 In addition to views presented regarding direct fund-to-fund transfers, some inquiry participants argued that it would be in members' best interests to exclude members with no alternative active account from the requirements to transfer low-balance, inactive accounts to the Commissioner. Submitters again cited higher investment returns as primary reason for this view.[142]

2.145 For instance, ASFA submitted that:

> 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.[143]

2.146 Link Group recommended that members with a single account should be excluded from any consolidation process. Link Group considered that such members 'will likely be disadvantaged by the proposed ATO consolidation, as their retirement savings will accrue only at CPI, rather than at super fund investment rate returns'.[144]

2.147 Cbus Super shared a similar view, submitting that:

> …small inactive accounts under $6000 (based on the broader activity test proposed above) be transferred directly to a member's active account. This would mean that auto-consolidation would not apply where the member does not have an active account in another fund.[145]

ATO deadline for consolidation

2.148 The ATO has estimated that, for an average account, it would take less than a month from the time funds are transferred to the ATO to when the funds are transferred to an active account.[146]

2.149 However, some submitters and witnesses expressed concern that there is no defined period of time set out in the bill in which the Commissioner must transfer funds to a member's active account.[147]

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142 See, for example, Australian Council of Trade Unions, *Submission 16*, p. 10; Association of Superannuation Funds of Australia, *Submission 12*, p. 8; Industry Super Australia, *Submission 26*, p. 15.

143 Association of Superannuation Funds of Australia, *Submission 12*, p. 8.

144 Link Group, *Submission 27*, p. 2.

145 Cbus Super, *Submission 32*, p. 15.

146 *Explanatory Memorandum*, p. 69.

147 See, for example, Industry Super Australia, *Submission 26*, p. 14; Association of Superannuation Funds of Australia, *Submission 12*, p. 9; AustralianSuper, *Submission 23*, p. 2.

2.150 For example, ASFA considered that:

> …should the money be required to go to the ATO or for the money that is already 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 higher fund returns.
>
> We recommend that strict deadlines should apply to the Commissioner for the return of members' money to their active accounts.[148]

2.151 Likewise, AustralianSuper submitted that 'the ATO should be subject to either a legislative timeframe or business benchmarking to determine their timeliness in reuniting members' unclaimed monies with their active superannuation accounts'.[149]

2.152 Mr Kirkland from CHOICE suggested to the committee that 'there should be a benchmark or a time frame set for trying to reunite 90 per cent of inactive funds with an active account within a month' and, additionally, 'there should be public reporting on how the ATO is performing against that'.[150]

2.153 In support of this view, Mrs Julia Davis, Policy and Communications Officer at Financial Rights, commented that 'I think transparent reporting [by the ATO] of how the process is going [to] be critical to making sure that it's an accountable process'.[151]

2.154 Mr James O'Halloran, Deputy Commissioner of Superannuation at the ATO, assured the committee that 'a month is certainly doable' with regard to how quickly funds can be transferred to an active account. Mr O'Halloran explained that, in allowing for consolidation without the explicit direction from the member, the bill will enable the transfer of funds as quickly as the ATO can identify a match with an active account:

> I've seen reference to this a few times in some of the submissions, but, at least as the administrator or the tax office, there is no interest in us holding the money. In fact, our track record, as I've discussed in other places, has been that we do it as quickly as we can identify a match. Up until now the hold-up has actually been getting the authorisation, if you like, from the person concerned and their conscious wishes of which fund or funds the money needs to be allocated to. So we would be seeing to run it as, really, a straight through process.[152]

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148 Association of Superannuation Funds of Australia, *Submission 12*, p. 9.

149 AustralianSuper, *Submission 23*, p. 2.

150 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 20 July 2018, p. 13. See also CHOICE, *Submission 15*, p. 18.

151 Mrs Julia Davis, Policy and Communications Officer, Financial Rights Legal Centre, *Committee Hansard*, 20 July 2018, p. 13.

152 Mr James O'Halloran, Deputy Commissioner, Superannuation Australian Taxation Office, *Committee Hansard*, 20 July 2018, pp. 95–96.

Committee view

2.155 There is no question that Australian society has changed since superannuation was first introduced. It is no longer the norm for people to work in the same occupation in the same industry for the entirety of their career. The average job tenure of Australians has considerably reduced, and there are a greater number of people employed on a part-time and casual basis. The superannuation system has also changed. The majority of funds are now public offer funds with a demographically broader member base. A one-size-fits-all approach, particularly with regard to fees and the provision of default insurance, is no longer appropriate. The superannuation system must to adapt to these changes in order to effectively meet the needs of its members.

2.156 Ensuring that Australians' superannuation balances are preserved for retirement is essential to the success of Australia's retirement income system. Effective regulations that promote product safety and suitably are therefore critical to guarantee the best interests of members are upheld. However, the current design of Australia's superannuation framework has led to extensive proliferation of accounts and serious erosion of members' balances through excessive fees and inappropriate insurance arrangements. The committee considers that the measures in this bill are an important first step in addressing these issues and will have tangible benefits for Australians' retirement savings.

2.157 The committee heard strong concerns during the inquiry in relation to the implementation timeframe in the bill. In particular, industry stakeholders expressed concern that the proposed commencement date of 1 July 2019 will be challenging due to a need to renegotiate the terms of contracts with insurers. While mindful of this concern, the committee considers that renegotiating insurance contracts is not an unfamiliar process to superannuation funds, and believes this process should be achievable within the proposed timeframe.

2.158 Stakeholders held differing views regarding the definition of an 'inactive' account as proposed by the bill; that is, an account will be considered to be inactive if no contributions or rollovers have been received in the previous continuous period of 13 months. Some argued for a longer and/or less narrow definition. The committee notes that the fundamental purpose of this reform is the consolidation of low-balance accounts that are unlikely to grow and are at risk of undue erosion. Consequently, the committee supports the more rigorous definition of inactivity adopted by the bill.

2.159 Retirement savings that are eroded by fees defeats the legislative intent of the superannuation system. The committee therefore welcomes the introduction of a fee cap on low-balance accounts and prohibition on exit fees proposed by the bill. The committee notes the government's estimates, based on the most recent data available, that these measures, combined with the rest of the package, will see members save around $570 million in fees in their first year of operation.[153]

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

2.160 The committee notes concerns raised by some stakeholders that members with accounts above the $6000 threshold may face increased fees. That said, the committee argues that this increase would only be a result of removing the cross-subsidy previously provided by low-balance account holders. Additionally, the committee considers that any small increase in fees borne by other members from prohibiting exit fees is appropriately balanced with the considerable member benefits that result from increased account consolidation.

2.161 The committee heard concerns that the proposed fee measures could be gamed. The committee is of the view that some of these concerns—in particular, those regarding possible member manipulation of the balance day test—are overstated and unlikely to be borne out in practice. The committee notes that, per section 99C of the SIS Act, buy-sell spreads are only to be charged on a cost recovery basis. Notwithstanding this existing protection, the committee suggests that consideration be given to ensuring close regulatory scrutiny around changes to the imposition of buy-sell spreads as a result of the fee measures in the bill.

2.162 The committee appreciates that insurance in superannuation provides a safety net for members and their dependents should their ability to earn an income and therefore save for retirement be impacted as a result of illness, injury or death. While the insurance covenants of the SIS Act require that the type and level of insurance in superannuation be appropriately balanced against the risk of erosion of members' retirement savings, it is apparent that the current balance between the protection provided and erosion of members' benefits is not aligned for some cohorts.

2.163 The committee recognises recent industry efforts to reduce inappropriate and duplicate insurance in superannuation, including the development of the *Insurance in Superannuation Voluntary Code of Practice* and movements by some funds toward age-based pricing for coverage. Notwithstanding this, the committee contends that industry action has been slow and does not go far enough to protect members' interests.

2.164 The impact of the insurance measures in the bill on insurance premiums was a common matter of concern raised during the inquiry. The committee recognises that members who continue to hold default insurance in superannuation may face increased premiums as a result of changes in the number of accounts as well as the overall risk profile of insured members. However, the committee stresses that any increases in insurance premiums that result from the proposed measures only demonstrate the substantial cross-subsidies that are inherent in the current system. As reported in recent research by Rice Warner, members aged 18 to 25 years are, on average, paying three times their true premium.[154]

2.165 The committee understands stakeholder concerns regarding the removal of default insurance coverage for some cohorts, specifically those employed in high-risk occupations. That said, the committee agrees with the principle highlighted in the Grattan Institute's submission that defaults should be set so that they are appropriate

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154 Rice Warner, *Federal Budget Impact—Insurance*, July 2018, p. 7.

for the most people. The committee also reminds stakeholders that the bill does not bar members impacted by the measures in the bill from electing to opt in to insurance. In addition, the committee notes that there are other support mechanisms, such as workers' compensation schemes and the Disability Support Pension, available to individuals affected by illness or injury.

2.166 Finally, with regard to the consolidation measures in the bill, the committee notes concerns expressed by some stakeholders regarding the proposed mechanism for the transfer of inactive account funds via the ATO. Given that the ATO has no pecuniary or reputational interest in retaining the funds and existing data matching techniques will be utilised, the committee is confident that the ATO will be able to proactively consolidate member funds with an active account within the estimated one-month timeframe and with limited impact on investment returns. The committee notes the government's estimates that these consolidation measures will see around $6 billion in retirement savings reunited with approximately three million individuals in 2019–20 alone.[155]

Recommendation 1

2.167 The committee recommends that the bill be passed.

Senator Jane Hume

Chair

155 *Explanatory Memorandum*, p. 56.

Additional Comments from Labor Senators

1.1 Labor Senators are cautiously supportive of the bill's broad objectives, note the measures contained within the schedules and will continue to evaluate possible amendments in order to improve the legislation.

1.2 Labor Senators will use these additional comments to set out views on the three schedules and also note particular concerns raised by stakeholders.

Important ongoing reviews into superannuation and insurance

1.3 Labor Senators note that this bill, which results from measures announced on Budget night 2018, was introduced at a time when significant reviews into group insurance arrangements within superannuation were being undertaken but not yet completed.

1.4 For example, the Productivity Commission is currently in the process of preparing a final report for Stage 3 of its inquiry into the competitiveness and efficiency of Australia's superannuation system. The terms of reference for the inquiry includes the following:

- the impact of insurance premiums on retirement incomes of both default cover and individually underwritten cover funded inside of superannuation
- the extent to which current policy settings offset costs to government in the form of reduced social security payments
- whether policy changes could improve default cover through superannuation, so that default cover:
    - provides value-for-money
    - does not inappropriately erode the retirement savings of members of all ages
    - delivers consistent outcomes across the system.
- whether policy changes are needed to ensure that insurance is not a barrier to account consolidation.[1]

1.5 Labor Senators note that it is unusual for the government to be proceeding with legislation in response to a draft Productivity Commission report rather than a final report.

1.6 The Royal Commission has also started inquiring into both superannuation and insurance arrangements within superannuation, as noted in the media[2] and the Royal Commission is due to issue its interim report by 30 September 2018.[3]

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1 Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness*, accessed via: https://www.pc.gov.au/inquiries/current/superannuation/assessment/terms-of-reference

2 ABC 7:30 Report, *Banking Royal Commission to look at superannuation insurance*, accessed via http://www.abc.net.au/7.30/banking-royal-commission-to-look-at-superannuation/10063336

1.7 Given these inquiries will be providing significant findings and providing recommendations to government, Labor Senators note concerns that further legislative changes might have to be considered not long after debate on this bill is concluded.

Schedule 1—Fees charged to superannuation members

1.8 Labor Senators broadly support the measures set out in this schedule. Labor Senators will make one substantial point on these matters, but note submissions provided to this inquiry which outline numerous concerns about the operation of this schedule. On these operational issues, Labor Senators encourage the government and Treasury to resolve these stakeholder concerns in a cooperative manner.

1.9 The primary concern Labor Senators have with this schedule is that the legislative framework might allow funds to simply reallocate fees and charges, which would diminish the intended outcome of this schedule.

1.10 As stated by consumer group CHOICE:

> We are concerned that some funds may attempt to game the 3% cap by shifting costs elsewhere. The legislation contemplates this mischief by allowing the regulations to list indirect fees and costs that must be included for the purpose of calculating the cap. To ensure there is adequate attention on any attempts to levy fees through indirect fees and costs we recommend that the regulator monitor and report on fees and be given the power to make delegated legislation to address unintended consequences. While the regulators are already empowered to monitor fees, as an accountability measure it is important that this monitoring is publically reported on and that the regulator be empowered to act via the regulations. We would expect public reporting to occur within two years of the reforms coming into force.
>
> …
>
> As with fee caps we are concerned that some providers may seek to game the prohibition by increasing other fees that may be charged on exit. For example, under the proposal funds are free to charge for buy/sell spreads.[4]

1.11 The Australian Institute of Superannuation Trustees (AIST) outlined similar concerns:

> Inconsistency between what is classified as 'fees' and 'indirect costs' provides an avenue for entities to game the fee capping requirements.
>
> …
>
> The exclusion of the sell component of buy/sell spreads means that exit costs could be gamed. This also affects how many members may be covered. To ensure that exit costs are not simply repackaged as part of the

3 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, accessed via https://financialservices.royalcommission.gov.au/Media/Pages/media-releases/Financial-Services-Royal-Commission-confirms-date-for-interim-report.aspx

4 CHOICE, *Submission 15*, pp. 5–6.

> buy/sell spread, the sell portion of buy/sell spreads should be included as part of exit fees.[5]

1.12 Labor Senators note testimony given by the Australian Prudential Regulation Authority (APRA) on these matters:

> **Mrs Rowell:** We would need to give consideration to whether we needed to have access to additional data to be able to monitor that on a more routine basis. We could monitor it through our regular supervision engagement and making information requests for the industry. However, often with these types of changes getting regular reporting that we can then review and look at would be important. I would have to say that some of the provisions in the bills that have not progressed—in particular, the expense look-through provision—would be important for us to be able to get the detailed information that we would need to be able to monitor the degree to which all relevant expenditure was being captured within the fee caps and the decisions that were being made.[6]
>
> …
>
> **Mr Summerhayes:** There is obviously an inherent cost in processing a member's exit and if that cost is not recovered, other things being equal, the cost would have to be recovered other ways and spread across the fee structure for the pool.
>
> …
>
> **Mr Summerhayes:** Yes. The funds do need to provide a member statement. They might have some one-on-one communication. It is not a process that comes without a cost burden for the funds, which, if they're not explicitly charging for it, would need to recover it in some other form.[7]

1.13 Given this evidence, Labor Senators believe that the government should task either Treasury or APRA with the responsibility for monitoring fund responses to this schedule. In evaluating any responses, they should determine whether such changes are appropriate in meeting the intent of the legislation. Labor Senators also note section 2.161 of the Chair's report which indicates that Coalition Senators are also supportive of this approach.

Schedule 2—Insurance for superannuation members

1.14 Labor Senators note the measures contained within this schedule and are continuing to evaluate possible amendments that would improve member outcomes.

1.15 Labor Senators note the history of group insurance within superannuation and the benefits these products bring to working Australians.

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5 Australian Institute of Superannuation Trustees, *Submission 10*, pp. 1–2.

6 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 5.

7 Mr Geoff Summerhayes, Member, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 5.

1.16 As outlined by the Australian Council of Trade Unions (ACTU):

> Superannuation in Australia was won by unions with an $11 promise: $9 for retirement, $1 for administration and $1 for insurance. This founding principle is the reason why we have such a comprehensive system of retirement savings and insurance in Australia, where workers are assured of the promise that, if the worst should happen to them at work or should they lose their ability to work, they and their families will not be left destitute. Through their superannuation, workers are afforded security in retirement, and security for themselves and their families during their working lives.[8]

1.17 As stated by the Productivity Commission, there are number of advantages that group insurance brings to the insurance market:

> There are a number of rationales that support the case for insurance in superannuation.
>
> - Superannuation provides a pooling mechanism to facilitate group insurance policies that can be provided more cheaply than individually underwritten policies. The cost effectiveness of group insurance is primarily attributable to lower distribution costs (there is no need to pay commissions to insurance agents to sell the product given the opt-out arrangements) but group insurance also has lower advice, administration and underwriting costs.
> - Group policies can charge lower premium costs by pooling risk and reducing adverse selection, particularly under opt-out arrangements. This means that an individual with higher risk factors can access insurance at a substantially cheaper rate than under an individually underwritten policy.
> - The default opt-out arrangements that facilitate group insurance assist in addressing reported problems of underinsurance.
> - There are potential benefits to individuals from having life insurance through superannuation compared with purchasing it outside of superannuation. It allows members to pay for insurance using funds that cannot otherwise be currently spent and that are taxed concessionally.[9]

1.18 However, Labor Senators also note some of the shortcomings of group insurance arrangements, as indicated by the establishment of the Insurance in Superannuation Working Group (ISWG).

1.19 Labor Senators also note the legislation contains a carve-out that can allow for the new insurance rules to not apply where an employer covers the full costs of the insurance in addition to its superannuation guarantee obligations.[10] This may allow

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8 Mr Joseph Mitchell, Workers' Capital Organising Officer, Australian Council of Trade Unions, *Committee Hansard*, 20 July 2018, p. 38.

9 Productivity Commission, *Superannuation: Efficiency and Competitiveness Draft Report*, pp. 312 –313

10 *Explanatory Memorandum*, p. 22.

certain enterprise bargaining outcomes to keep opt out arrangements in some circumstances.

1.20 Labor Senators have also listened to stakeholders and are very cognisant of the following concerns they have raised:

(a) The start date for insurance arrangements;

(b) Potential impacts on high risk occupations;

(c) The 13-month definition of inactivity;

(d) Insurance coverage for people with active accounts with a balance of less than $6000;

(e) The age threshold of 25 years; and

(f) The anti-selection problem raised by opt in arrangements.

1.21 Labor Senators will continue to evaluate these concerns and seek to find suitable amendments that improve the legislation.

Concerns about the start date for insurance arrangements

1.22 As stated in the Explanatory Memorandum, the proposed Date of Effect is 1 July 2019.[11]

1.23 Stakeholders from across the industry raised concerns about the proposed start date for the group insurance arrangements within superannuation and the impacts this legislation could have on members.

1.24 The Association of Superannuation Funds of Australia (ASFA) stated that:

> 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.[12]

1.25 The major group insurers also indicated the same concerns. For instance, as described by AIA Australia:

> 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.

11 *Explanatory Memorandum*, p. 3.

12 Association of Superannuation Funds of Australia, *Submission 12*, p. 1.

> 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 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.[13]

1.26 Rice Warner echoed similar concerns:

> The insurance changes are due to take place from 1 July 2019, requiring that members be given notice by 1 May 2019 so that they can choose to opt in to retain their cover before the commencement date.
>
> Given the significance of these changes, funds will likely need to renegotiate the terms of their contracts with insurers. This is a process which requires significant time and resources from both the fund and the insurer. This exercise would generally commence at least one year before implementation and for most funds occurs every three years. This means that insurers will require considerably more resources to be able to deal with pricing requirements.[14]

1.27 APRA in testimony to this committee also outlined reasons why it believed a 1 July 2019 start date was problematic for Schedule 2:

> To implement all of these proposals, funds will need to work closely with their administrators and insurers to ensure the required system changes and amendments to group insurance arrangements are in place. This will be challenging to achieve by the proposed implementation date of 1 July 2019, given both the complexity and extent of the changes that will be required to be made across the entire superannuation sector. In particular, insurance arrangements will need to be reviewed and repriced, taking into account actuarial input; underwriting processes reviewed; and contractual

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13 AIA Australia, *Submission 17*, p. 14.

14 Rice Warner, *Submission 7—Attachment 1*, p. 7.

> arrangements renegotiated accordingly. These processes can be highly complex and time consuming for individual superannuation funds, and will be even more so when the industry as a whole is impacted. Sufficient time also needs to be allowed for effective communication to members of the changes that are being made, their expected impact and the decisions that members may need to make, particularly in relation to insurance. This in turn will require certainty in the final legislative requirements so that the nature and extent of the changes to insurance and fees can be determined by each superannuation fund in collaboration with their service providers, and to enable funds' current disclosure obligations to be met.
>
> APRA is therefore concerned that unintended consequences may arise for members and that there will be significant pressure on and heightened operational risk for super funds and their insurers and administrators if sufficient time is not allowed to implement the proposals in an appropriate and orderly manner.[15]

Potential impacts on high risk occupations

1.28 A number of stakeholders were concerned that workers in high risk occupations who currently are covered by default insurance arrangements might not be able to access equivalent insurance through retail insurance channels due to a lack of market offerings and retail insurer risk appetite. Submissions also stated that it could be quite likely that those workers who chose to opt in might face a combination of underwriting processes, higher premiums and reduced cover.

1.29 Rice Warner stated that some members might have trouble accessing adequate insurance arrangements:

> Superannuation funds may be the only option to obtain insurance cover for individuals working in a range of high risk occupations. We believe this is a particularly valuable service to these members. By offering opt-out cover to large numbers of members in these occupations, some funds have been able to negotiate the provision of cover to these members. For some occupations it could be difficult to obtain automatic cover outside group insurance through the superannuation environment. Members in these occupations may be unable to replace their cover if it was reduced or removed.[16]

1.30 The joint submission by the Consumer Action Law Centre and the Financial Rights Legal Centre through the Treasury consultation raised similar concerns:

> Workers compensation schemes may cover many younger people in high risk work. However, if the Government's view is that private life insurance is an important financial protection, this insurance must be accessible and

15 Mrs Helen Rowell, Deputy Chair, Australian Prudential Regulation Authority, *Committee Hansard*, 20 July 2018, p. 2.

16 Rice Warner, *Submission 7—Attachment 1*, p. 3.

> affordable for the young people who need for it. This will include young people with dependents and/or in high risk work.[17]

1.31 The ACTU's position is that insurance arrangements should remain opt-out for those in high risk occupations:

> The ACTU believes that workers in high-risk industries should be required to opt-out of their insurance policies, and the Government should delay implementation until a comprehensive consultation process with unions, employers, funds and insurers is completed to ensure the significantly detrimental gaps are filled.[18]

1.32 The Corporate Superannuation Association stated its belief that all members should be covered by automatic insurance:

> However, in situations where the member does bear the cost and is in a high risk occupation [as opposed to the employer covering such costs], or in a remote or sensitive location, we believe that it is in the best interest of the member to be covered automatically.[19]

1.33 Industry Super Australia (ISA) highlighted the consequences that might be faced by workers in high risk occupations:

> The problem is compounded by the inevitability that workers in high-risk industries or those with an obvious need for insurance cover, in the absence of group default insurance cover, will find it difficult to obtain the cover. **Where high-risk workers self-select and seek cover, insurers will either not offer cover or require underwriting. In addition, where cover will be offered, it is very likely to be limited in its cover and, undoubtedly, more expensive.** Most workers employed in high-risk occupations where default group insurance is not provided will not have the option of opting into insurance.[20]

Concerns about the 13 month definition of inactivity

1.34 A number of submissions raised concerns that the combination of 12 months of parental leave with current quarterly superannuation guarantee payments made a 13-month definition of inactivity problematic in some circumstances.

1.35 For instance, Rice Warner stated that:

> The amended definition of inactivity may prove problematic. A period of 13 months may be insufficient to define an account as inactive, as:
>
> - Superannuation Guarantee (SG) payments can be made quarterly so people going on parental leave for 12 months could have a period of 15 months between SG payments.

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17 Financial Rights Legal Centre and Consumer Action Law Centre, *Submission 11—Attachment 1*, p. 5.

18 Australian Council of Trade Unions, *Submission 16*, p. 7.

19 Corporate Superannuation Association, *Submission 6*, p. 3.

20 Industry Super Australia, *Submission 26*, p. 8.

- Some people will be on parental leave for longer than 12 months, or may have a delay in finding a suitable new role after a planned period out of the Australian workforce to work overseas, study, raise children or provide care to relatives.[21]

1.36 MetLife Insurance Limited (MetLife) concurred:

> MetLife is concerned that the 13 month inactivity rule could have a discriminatory effect on women. One of the reasons that contributions cease is that an employee has an extended period of parental leave. It is usually women who bear the bulk of parenting responsibility and who would be most affected by this change. This problem will be particularly acute for women who have casual or part-time roles and are more likely to have interrupted work patterns, such as those who work in the retail industry.
>
> The proposed timeline of 13 months does not fit with the obligations under the Fair Work Act to provide employees who have more than 12 months service with up to 24 months of parental leave following the birth or adoption of a child.[22]

1.37 ASFA argued for a definition of 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.[23]

1.38 The ACTU argued for a more nuanced approach to the definition of activity:

> The definition of inactivity proposed under the legislation is hugely problematic. 13 months without a contribution does not reflect the engagement of the member with their account. The ACTU believes that should a member be active in investment choices, changing insurance policies, changing their details or beneficiaries, the Fund should be allowed to deem them an active account holder. The regulator should be empowered to work with Funds to determine when an account is active, so that those intending to keep their superannuation insurance are not punished for missing communiques from their Fund.[24]

21 Rice Warner, *Submission 7—Attachment 1*, p. 2.

22 MetLife Insurance Limited, *Submission 9*, p. 4.

23 Association of Superannuation Funds of Australia, *Submission 12*, p. 8.

24 Australian Council of Trade Unions, *Submission 16*, p. 9.

Concerns about insurance coverage for people with active accounts with a balance of less than $6000

1.39 The ACTU pointed out that it could take a long time for new entrants to the workforce (whether young people or migrants) to accumulate the minimum $6000 threshold:

> But the problem is extended to more than just young workers. A worker on the median wage, around $55,000, would need to work 14 months to be defaulted into insurance through this system, regardless of their circumstances. This law would strike out many who one day will need continuous insurance coverage.[25]

1.40 This problem is so significant that the Financial Rights Legal Centre, in a departure from consumer group CHOICE, believed that active accounts (that is, accounts receiving contributions) less than $6000 should continue to have an opt out insurance regime:

> Where anything under $6,000 switches to an opt-in? Our biggest concern is that I know that CHOICE has argued that in an ideal world people who are on low incomes would be better serviced from just being a part of the DSP and getting funded by government in that way. I don't disagree with that on principle. I think that that is a much more socially aware and sustainable situation but, in practice, it's quite hard to get approved for DSP right now. The eligibility for DSP since 2011 has really tightened, and we worry that a lot of people with low amounts of super really wouldn't qualify for the DSP. Maybe their family actually has enough assets that they wouldn't qualify or they make money because they're in and out of a high-risk industry; that super account isn't growing beyond $6,000. We just think there are vulnerable communities that fall inside these low-amount accounts, like people in Aboriginal communities, people with mental illness, people with itinerant types of careers or new migrants who've just arrived—they are all people that we'd be concerned about them not having default insurance. We know that, when you first start a job or if you are in and out of a job, you probably aren't aware. That's us trying to protect people and make sure that they have some sort of disability protection or life protection.[26]

1.41 The Financial Services Council (FSC) also agreed with this position:

> We do not understand the policy rationale for providing default insurance cover to people who are actively contributing to their accounts only when their balance reaches $6,000. Creating a lag in insurance cover for new members with active accounts appears to be an unintended consequence of the proposals.
>
> Providing active members with cover from the time they join would make it simpler for people to know when their cover starts, and potentially avoid

25 Mr Joseph Mitchell, Workers' Capital Organising Officer, Australian Council of Trade Unions, Committee Hansard, 20 July 2018, p. 38.

26 Mrs Julia Davis, Policy and Communications Officer, Financial Rights Legal Centre, *Committee Hansard*, 20 July 2018, p. 10.

> underwriting issues for people choosing to opt-in from the outset. It would also avoid the complexity resulting from linking the start date for insurance to the member's account balance. For example, for some investment options, the balance of the account is not immediately available.[27]

Concerns about the age threshold of 25 years

1.42 Evidence received by this committee indicates that the example of AustralianSuper was a driving reason for why the government proceeded with an age threshold set at 25 years:

> We've come to the view that younger people have less need for life insurance, and therefore that it shouldn't be a default. I think you then have to establish a threshold at which someone is old enough that on a default basis they receive automatic cover. Twenty-five is the answer that we adopted, the PC adopted and AustralianSuper adopted. It's not the only answer, but it seems to be one that probably has general support within the industry. As I think the previous witness noted, we're designing an overall default system. From that perspective, 25 seemed like an appropriate threshold.[28]

1.43 However, there were a number of funds who stated that their under-25 members were much more likely to have significant assets and have dependents.

1.44 ISA stated that major life decisions are often made at the age of 22:

> Whilst it is accepted that younger members generally are less likely to have financial dependants and obligations, empirical data reveals insurance needs crystallise in the early rather than mid 20's for most.
>
> Workers from the age of 22 are significantly more likely to have insurance needs. After the age of 22, workers are more likely to have completed their studies, be employed full-time and have obtained social and financial responsibilities.[29]

1.45 Individual funds raised similar points. For instance, Cbus Super and Rest stated that:

> Cbus members are primarily male and blue collar, and skew towards a younger demographic. They tend to start full time work at a younger age, and most assume financial responsibilities for others from 21 years of age.[30]
>
> Unlike young people who may be living at home or attending university and only working intermittently, Rest members rely on their income. Their insurance is valuable to them and their dependants. For many their ability to earn a living is their most important asset. Rest's insurance is created with this in mind.

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27 Financial Services Council, *Submission 25*, p. 3.

28 Mr Ian Beckett, Principal Adviser, Retirement Income Policy Division, The Treasury, *Committee Hansard*, 20 July 2018, p. 93.

29 Industry Super Australia, *Submission 26*, p. 9.

30 Cbus Super, *Submission 32*, p. 3.

> …
>
> We have paid more than $50 million to members who are younger than 25 and have passed way, leaving dependent partners and children behind, or have suffered a disability that left them unable to work.[31]

1.46 Funds have also taken steps to reduce or eliminate any age-based cross subsidisation. For example, Rest in its submission outlined how an 18 year old Rest member pays $1.11 per week for insurance, scaling to $4.85 per week for a 25 year old.[32] Such arrangements are greatly impacted by the government's approach in this legislation.

1.47 TAL Life Limited (TAL) in testimony given at the hearing explained how some funds will be impacted by this age threshold:

> The third area we believe needs to be addressed is in relation to young members. This has been touched on already by a number of members who've presented today. There is no question that the insurance needs of young members can be different to other superannuation fund members. They may not have accumulated dependents or liabilities, which typically support the need for life insurance; however, this is not consistently the case across all cohorts of members and across all funds. For example, members of a super fund that supports blue-collar workers are more likely to have more comprehensive insurance needs at an earlier age than a fund that supports professional workers. This is particularly important for funds that support members in high-risk occupations, where insurance cover may not be available elsewhere in the system. Trustees are well positioned to understand and accurately provide for the retirement insurance needs of their fund members, and in many cases tailor benefits to their membership. Therefore, we're recommending that, to allow trustees to have the necessary flexibility, they determine the appropriate minimum age for providing automatic life insurance cover to their members aged between 21 and 25.[33]

Concerns raised about the anti-selection problem raised by opt in insurance arrangements

1.48 Opt in insurance arrangements present the problem of adverse-selection. That is, people with a relatively higher risk of claiming will form the majority of people who opt in, therefore raising the average risk of the pool, and increasing premiums that must be charged to cover these increased risks. Insurers are presented with three major options to address this risk. As stated by ISA at section 1.33 of these additional comments, insurers can raise premiums for the entire pool of insured members, cover can be reduced for the entire pool or those who opt in will face an underwriting process.

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31 Rest, *Submission 22*, p. 1.

32 Rest, *Submission 22*, p. 6.

33 Mr Brett Clark, Group CEO and Managing Director, TAL Life Limited, *Committee Hansard*, 20 July 2018, p. 61.

1.49 In response to this problem, the ACTU argued that this schedule should be opposed until an agreed solution is reached:

> Furthermore, an advantage of the group insurance default model is that members are not subject to selection biases—that is, if a person opts in to insurance then they must have a reason to, meaning that insurance costs will rise for simply doing the right thing for their circumstances, and this is without considering the additional price increases associated with breaking the group insurance model. The ACTU recommends that the insurance provisions of the bill be opposed until a meaningful and careful solution can be found so that workers are covered by insurance that is appropriate for them.[34]

1.50 CHOICE offered one other solution, which is for the introduction of a community rating system:

> Our suggestion is that it would be important to apply the benefits of the group insurance system to people who choose to opt in under this regime, particularly younger people. As APRA was explaining towards the end of its evidence, it is effectively a community rating system. You've got people pools—they're not individually underwritten—which has a lot of benefits. It's cheaper to administer. It also means that there are people who get access to insurance who might otherwise be denied insurance. It would be a shame if, under this regime, there were people who were no longer part of that group insurance—for very good reason, as we've outlined in our submission—but if they chose to opt in they were then subject to a different form of insurance that didn't have those benefits. They'd be underwritten, they might be subject to exemptions and they might be subject to different pricing. So what we're saying is these are people who are already insured now, and if they choose to opt in under these reforms they should be opting into the same insurance arrangements they would have now. It should be something that I would think funds, insurers and members, if they were able to understand it, would welcome.[35]

1.51 Labor Senators note these anti-selection concerns and the possible impacts they will have on premium pricing, coverage and underwriting processes. Labor Senators believe it is incumbent on the government to monitor outcomes resulting from decisions that funds and insurers agree to. Labor Senators will continue to work toward a system where appropriate insurance is not denied, or priced at unaffordable levels, for key cohorts impacted by this bill.

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

1.52 Labor Senators support the intent of this schedule, which seeks to provide new powers to the Australian Taxation Office (ATO) in reducing multiple accounts.

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34 Mr Joseph Mitchell, Workers' Capital Organising Officer, Australian Council of Trade Unions, *Committee Hansard*, 20 July 2018, p. 38.

35 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 20 July 2018, p. 38.

Labor Senators also note the many submissions which called for the ATO to have a level of public accountability when exercising these powers.

1.53 The ACTU outlined its concerns about the impacts of funding cuts on the ATO and its view that the government should set a clear expectation for the ATO:

> **Senator KETTER:** In relation to the ATO's new or enhanced role in the consolidation of accounts: can you tell us what your expectations of the ATO are, at the moment, and particularly in the context of where there have been cuts to funding for the ATO?
>
> **Mr Mitchell:** I worry that the ATO isn't well resourced enough to take on this role. There have been significant cuts to the Public Service. But, more pressingly, it's the members' interests which we should consider chiefly; they should not spend a significant amount of time in earning the cash rate, and there should be some compulsion from government to the ATO that it meets the target, or there should be a preference order, where if there is no fund to consolidate to and the member is earning a higher return than the cash rate then they stay in the fund—if there is a fund to consolidate to, it never really goes to the ATO; it goes straight from fund to fund—or, if it is earning below the cash rate, then it should be consolidated into the ATO, until an appropriate fund is found. And the members should be notified as often as possible that their retirement savings are in the ATO, which is usually a suboptimal outcome.[36]

1.54 CHOICE stated that public reporting can help manage competing priorities that the ATO might have:

> We broadly support this measure as it will see billions of dollars flowing into the active accounts of people. However, we are concerned that the proposal contains no timeframes for the ATO to conduct a consolidation. The ATO has a number of competing priorities – giving it this new responsibility without additional funding or a timeframe in which to complete the activity risks delays. There is also a threat to the ATO‟s reputation if a belief forms that the regulator is delaying consolidation in order to boost government finances. This reputational risk is not good for building important tax payer trust in the institution. We recommend the ATO be given adequate resources to complete this new function, that it have deadlines for consolidation where an active account exists and that it report against this metric.
>
> …
>
> Recommendation 11 - Give the ATO adequate resources to consolidate accounts. That the ATO meet a deadline for reuniting at least 90% of eligible funds within one month of receipt and publically report on its performance.[37]

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36 Mr Joseph Mitchell, Workers' Capital Organising Officer, Australian Council of Trade Unions, *Committee Hansard*, 20 July 2018, p. 43.

37 CHOICE, *Submission 15*, pp. 17–18.

1.55 ASFA stated that it is important that the ATO be accountable for its actions and that accounts are receiving higher returns as quickly as possible:

> 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.[38]

1.56 Stakeholders in the superannuation sector such as ASFA, ISA and AIST all believed that the transfer of balances held in inactive accounts should be directly from fund to fund, not through the ATO:

> 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.[39]

> The Commissioner should not function as an intermediary to consolidate inactive low-balance accounts where an active account has been identified within 60 days after the unclaimed money day. ISA encourages the Committee to consider that direct fund to fund account consolidation is more efficient and in the best interests of members. It enables members' savings to continue accumulating earnings during the consolidation process.[40]

> AIST supports a mechanism based on direct fund-to-fund transfer of inactive accounts to active accounts, based on data provided by the ATO to funds[41]

1.57 Labor Senators also note testimony given by the ATO which outlined its intent to reunite most accounts within 30 days and to be accountable for its actions:

> …I've heard the commentary and read in submissions what might be deemed a service standard or at least tracked reporting on how quickly we're reuniting upon receipt of information coming in from the funds. Under the current arrangements, we probably have a matching rate, if you like, upon receipt of the data—but obviously conditional on the data from the funds—probably in the order of 75 to 83 per cent. It bounces around a little bit. In terms of once we can do a match, I've seen reference around how quickly we can then transmit that out. We certainly think that in this quite significant year, subject to the legislation, a month is certainly doable.
> …

> If you're talking about a performance report, either voluntary or otherwise, in principle it's not unusual for us to report matters of interest in terms of, if you like, service standards or turnaround et cetera. We probably haven't

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38 Association of Superannuation Funds of Australia, *Submission 12*, p. 9.

39 Association of Superannuation Funds of Australia, *Submission 12*, p. 9.

40 Industry Super Australia, *Submission 26*, p. 15.

41 Australian Institute of Superannuation Trustees, *Submission 10*, p. 6.

> done it until now, though I'm happy to go through some figures now if you wish around how our current arrangements work, but certainly we'll be tracking it. I've seen reference to this a few times in some of the submissions, but, at least as the administrator or the tax office, there is no interest in us holding the money.[42]

1.58 Given this evidence, Labor Senators believe that the government should set performance targets for the ATO in exercising powers given in this legislation, and on a regular basis the ATO should provide a public report which outlines performance against these targets. Labor Senators believe that a 30 day timeframe for the consolidation of most accounts is both achievable for the ATO and in the interests of members.

Conclusion

1.59 Labor built Australia's superannuation system. Labor Senators will always work to ensure that it is fair, sustainable and sets Australians up for a comfortable life in retirement.

1.60 Labor Senators support the broad intent of this bill, which is to minimise the erosion of superannuation accounts.

1.61 Labor Senators also note the history of insurance arrangements, often provided as an outcome of industrial bargaining arrangements and note the many benefits that group insurance can bring to the financial services sector, providing affordable insurance to many working Australians. Labor Senators will continue to work towards the objective of insurance arrangements within superannuation that are affordable, well designed and provides a benefit that outweighs the impact on superannuation balances.

Senator Chris Ketter
Deputy Chair

Senator Jenny McAllister
Senator for New South Wales

42 Mr James O'Halloran, Deputy Commissioner, Superannuation Australian Taxation Office, *Committee Hansard*, 20 July 2018, pp. 95–96.

Appendix 1
Submissions and additional documents

Submissions

1. Anglicare Australia
2. ClearView Wealth
3. Maurice Blackburn Lawyers
4. Dixon Advisory
5. Berrill & Watson
6. Corporate Superannuation Association
7. Rice Warner
8. Chartered Accountants Australia and New Zealand
9. MetLife Insurance Limited
10. Australian Institute of Superannuation Trustees
11. Financial Rights Legal Centre and Consumer Action Law Centre
12. Association of Superannuation Funds of Australia (ASFA)
13. Munich Reinsurance Company of Australasia Limited
14. RGA Reinsurance Company of Australia Limited
15. CHOICE
16. Australian Council of Trade Unions (ACTU)
17. AIA Australia
18. QSuper
19. Mercer
20. Law Council of Australia
21. Queensland Council of Unions
22. Retail Employees Superannuation Pty Ltd (Rest)
23. AustralianSuper
24. Association of Financial Advisers (AFA)
25. Financial Services Council
26. Industry Super Australia
27. Link Group
28. SMSF Association

29. Financial Counselling Australia (FCA)
30. COTA Australia
31. TAL Life Limited
32. Cbus Super
33. Grattan Institute
34. Confidential

Answers to questions on notice

1. Clearview: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 27 July 2018.
2. Australian Taxation Office: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 30 July 2018.
3. Financial Services Council: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 2 August 2018.
4. Association of Superannuation Funds of Australia: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 30 July 2018.
5. Australian Council of Trade Unions: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 1 August 2018.
6. Rice Warner: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 30 July 2018.
7. AIA Australia: Answers to written questions taken on notice, received 1 August 2018
8. Department of Social Services: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 2 August 2018.
9. MetLife: Answers to written questions taken on notice, received 2 August 2018.
10. TAL Life Ltd: Answers to written questions taken on notice, received 2 August 2018.
11. Treasury: Answers to questions taken on notice at a public hearing in Sydney on 20 July 2018, received 3 August 2018.

Tabled documents

1. Document tabled by Rest at a public hearing in Sydney on 20 July 2018.
2. Document tabled by Treasury at a public hearing in Sydney on 20 July 2018.
3. Document tabled by AustralianSuper at a public hearing in Sydney on 20 July 2018.

Additional information

1. Document provided by Association of Superannuation Funds of Australia on 30 July 2018.

Additional hearing information

1. Opening statement provided by the Australian Prudential Regulation Authority (APRA) at a public hearing in Sydney on 20 July 2018.
2. Document provided by AIA Australia at a public hearing in Sydney on 20 July 2018.
3. Opening statement provided by the Association of Superannuation Funds of Australia (ASFA) at a public hearing in Sydney on 20 July 2018.
4. Opening statement provided by MetLife at a public hearing in Sydney on 20 July 2018.
5. Opening statement provided by Rest at a public hearing in Sydney on 20 July 2018.
6. Opening statement provided by TAL Life Limited at a public hearing in Sydney on 20 July 2018.
7. Correction of evidence provided by the Australian Taxation Office following a public hearing in Sydney on 20 July 2018.

Correspondence

1. Correspondence received from the Australian Prudential Regulation Authority (APRA) on 5 July 2018.

Appendix 2

Public hearings

Sydney, 20 July 2018

Members in attendance: Senators Bushby, Hume, Ketter, Stoker.

ADDISON, Mr Byron, Senior Policy Adviser, Association of Superannuation Funds of Australia

BAXTER, Ms Jenni, Executive General Manager, Insurance, Rice Warner

BECKETT, Mr Ian, Principal Adviser, Retirement Income Policy Division, The Treasury

BINNS, Ms Natalie, Head of Insurance, Rest

BURGESS, Mr Geoff, Deputy Chairman, Corporate Superannuation Association Inc.

CAMPO, Ms Robbie, Group Executive, Brand, Advocacy, Marketing and Product, Cbus

CERCHE, Mr Mark, Chair, Corporate Superannuation Association Inc.

CLARK, Mr Brett, Group CEO and Managing Director, TAL Life Limited

DALEY, Professor John, Chief Executive Officer, Grattan Institute

DAVIS, Mrs Julia, Policy and Communications Officer, Financial Rights Legal Centre

DEITZ, Mr Andrew, Manager, The Treasury

DOYLE, Ms Vicki, Chief Executive Officer, Rest

du PRE-ALBA, Ms Louise, Strategic Policy Advocate, AustralianSuper

FOGARTY, Mr Wayne, Adviser, Policy Development, Australian Prudential Regulation Authority

HANSELL, Mr Allan, Director of Policy & Global Markets, Financial Services Council

HAYNES, Mr David, Senior Policy Manager, Australian Institute of Superannuation Trustees

KIRKLAND, Mr Alan, Chief Executive Officer, CHOICE

KIRWAN, Mr Nick, Senior Policy Manager (Life Insurance), Financial Services Council

KOHLHAGEN, Mr Peter, Senior Manager, Policy Development, Australian Prudential Regulation Authority

KRNCEVIC, Mr Jesse, Senior Policy Manager, Financial Services Council

LINDEN, Mr Matthew, Director, Public Affairs, Industry Super Australia

MITCHELL, Mr Joseph, Workers' Capital Organising Officer, Australian Council of Trade Unions

MU, Mr Damien, Chief Executive Officer, AIA Australia and New Zealand

O’HALLORAN, Mr Xavier, Campaigns and Policy Team Lead, CHOICE

O'HALLORAN, Mr James, Deputy Commissioner, Superannuation, Australian Taxation Office

RICE, Mr Michael, Chief Executive Officer, Rice Warner

ROWELL, Mrs Helen, Deputy Chair, Australian Prudential Regulation Authority

SUMMERHAYES, Mr Geoff, Member, Australian Prudential Regulation Authority

SWANSON, Mr Simon, Managing Director, ClearView Wealth

WATT, Mr Vincent, Acting Chief Executive Officer, MetLife Insurance Limited

WATTS, Mr Richard, Consultant, Industry Super Australia

WEATHERHEAD, Mr Richard David, Head of Insurance, AustralianSuper

WHITTON, Mr Ken, Senior Policy Adviser, Association of Superannuation Funds of Australia