Lawyers for the People

AUSTRALIAN LAWYERS ALLIANCE

Superannuation: Assessing Efficiency and Competitiveness

Stage 3: Assessing Efficiency and Competitiveness

Submission to the Productivity Commission regarding the Draft Report

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Who we are

The Australian Lawyers Alliance (ALA) is a national association of lawyers, academics and other professionals dedicated to protecting and promoting justice, freedom and the rights of the individual.

We estimate that our 1,500 members represent up to 200,000 people each year in Australia. We promote access to justice and equality before the law for all individuals regardless of their wealth, position, gender, age, race or religious belief.

The ALA is represented in every state and territory in Australia. More information about us is available on our website.[1]

[1] www.lawyersalliance.com.au.

Introduction

1. The ALA welcomes the opportunity to provide this submission in relation to the Productivity Commission's draft report into the efficiency of the superannuation system. The Productivity Commission's draft report is expansive and covers many facets of the superannuation system. This submission is focused on issues relating to insurance and account consolidation.

2. The deduction of insurance premiums from a members account over the member's working life can have a material effect on the amount of retirement savings with which they will ultimately be able to retire. Given this, the ALA believes that insurance in superannuation should be:

   (a) reasonably priced;

   (b) provide a reasonable amount of basic insurance cover; and

   (c) provide reasonable insurance terms (product design).

3. In assessing insurance in superannuation, it is important to remember that aside from being a cost, the insurance in superannuation provides a substantial benefit. The insurance cover provided through group superannuation products has provided many billions of dollars of financial support to injured and sick people.

Under 25s

4. The ALA notes draft recommendation 14 of the Productivity Commission's reportwhich recommends that members under the age of 25 should have opt-in insurance cover.

5. The ALA welcomes and agrees with that recommendation insofar as it concerns life/death insurance, because a significant majority of under 25s do not have financial dependants, or mortgages. Accordingly, life/death insurance is not well targetted as a default insurance product for under 25 year olds.

6. While the ALA supports this position regarding death cover, we have some reservations about compulsorily removing default disability insurance cover for members under the age of 25. Our reservations arise due to five basic reasons. They are:

(a) Evidence suggests that Australian households are carrying some of the highest average debt levels of all OECD countries and that many Australian households are experiencing an underinsurance problem, including young families.[2] Compounding this problem for those aged 25 years and over through the proposed changes would be an unfortunate and unintended consequence;

(b) Removing a large number of Australians from the risk pool is likely to increase the cost of insurance cover for the remaining insured members;

(c) There are many people under the age of 25 who suffer disability, injury or chronic illness (particularly those working in manual, hazardous occupations) and it is in reality impossible to determine when these conditions arise;

(d) Young people who are sick, injured or chronically ill have long-term exposure to the additional cost of disability, such as medical costs, home modifications, etc; and

(e) The heightened levels of disengagement among younger workers which makes them less likely to opt in to insurance if it is appropriate for their circumstances (eg, if they have dependants).

7. There are currently more than 900,000 full-time and 832,000 part-time workers in Australia under the age of 25.[3]

8. The ALA believes that it is critical that insurance in superannuation remains sustainable. That will be achieved only if it is reasonably priced. We would defer to the actuarial houses to provide the data in relation to anticipated premium impacts. We respectfully suggest that the Productivity Commission should seek data to provide evidence on the impact on premiums if under 25s were given Total and Permanent Disablement Insurance (TPD), but not death cover on an opt-out basis.

9. It is also noted that some superannuation funds in the hospitality industry and retail industry will have comparatively high numbers of young members and accordingly any impact caused

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[2] *Rice Warner Underinsurance in Australia 2015 found the median level of life cover met just 61 per cent of basic needs and 37 per cent of the income replacement level. See also [http://www.ricewarner.com/australias-relentless-underinsurance-gap/.](http://www.ricewarner.com/australias-relentless-underinsurance-gap/)*

[3] *Ref ABS spreadsheet 63100DO012_201308 Employee Earnings, Benefits and Trade Union Membership*.

by the exclusion of under 25s from the risk pool will have a disproportionate impact on those funds. Accordingly, while it is an obligation on a Trustee of a MySuper product to provide an insured with permanent incapacity benefit,[4] we suggest that it may be appropriate to allow MySuper Trustees to determine the appropriateness or otherwise of insurance for under 25s in respect of the population/demographic of that particular fund. That would be consistent with the Trustees' existing obligations under s52(7) *Superannuation Industry (Supervision) Act 1993* ('the SIS Act'), to formulate and regularly review an insurance strategy in respect of its membership.

10. We point out that people who work in the retail and hospitality industry often have low account balances in superannuation. If, as is predicted, there would be an increase in the cost of premiums, people in these sectors are likely to suffer significant detriment from the compounded problem of:

    a. low account balances; and

    b. a disproportionate increase in insurance premiums.

11. We also point to the large representation of young people who work in construction and who consequently have a greater need for TPD insurance coverage than their older counterparts in less dangerous or physically taxing professions.

12. It is for these reasons that the ALA supports the Trustee of a default fund having the ability to consider the impact of insurance cover and premiums on members under 25 years old and having the discretion to provide automatic disability cover to any of its members, subject to meeting its fiduciary and other legal obligations.

Account Consolidation – Tax implications

13. We welcome the recommendations relating to the consolidation of lost/inactive accounts and believe that these measures will deliver considerable savings to superannuation members over their working lives.

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[4] S.68AA *Superannuation (Industry Supervision) Act 1993.*

14. While the consolidation of lost/inactive accounts is in our view good policy, we would like to raise a significant unintended consequence of consolidation that will result in substantially higher tax liability for members and therefore reduce their retirement savings.

15. When a member of a superannuation fund applies for the release of their superannuation on the grounds of permanent incapacity (whether the benefit includes an insured component or not), there is some tax payable in respect of that benefit. The benefit which is released from the superannuation environment has a taxable and a tax-free component.

16. The amount of the tax-free component of the benefit has to be calculated by reference to a formula, part of which is as follows:

$$\frac{\text{Amount of benefit} \times \text{days to retirement}}{\text{Service days} + \text{days to retirement}}$$ [5]

17. Importantly, the Eligible Service Date (ESD) which is used to calculate the service days refers to the date that a member joined that particular superannuation fund.

18. Put simply, the later in time the Eligible Service Date, the larger the tax-free component.

19. However, when two superannuation accounts are rolled together, the ESD that is the earliest of the two funds will be adopted as the ESD for the purposes of the calculation. Accordingly, where an account consolidation has occurred as contemplated by the changes recommended by the Productivity Commission, a member claiming superannuation on the grounds of disability/permanent incapacity will pay more tax than they would have had their accounts remained as they were.

20. For example, a 40 year old has a $150,000 TPD claim approved through their superannuation account, which was commenced in 2010. If they were to make a full withdrawal of this benefit, the tax payable would be roughly $7,000. The claimant has another inactive superannuation account which was commenced in 1998, which is then automatically consolidated into this superannuation account. Now if the member makes a full withdrawal from this account, the tax payable will be roughly $14,000.

[5] https://www.ato.gov.au/super/apra-regulated-funds/paying-benefits/calculating-components-of-a-super-benefit/?anchor=Working_out_the_components_of_a_super_benefit#Working_out_the_components_of_a_super_benefit.

Inactive Accounts – Insurance Implications

21. The ALA supports the recommendation to cease insurance cover on inactive accounts where there has been no contribution for a period of 13 months.

22. For many members of super funds who have significant medical history, obtaining insurance cover through superannuation may be their only hope of ever having a basic level of insurance cover. Accordingly, it is critical that there are appropriate notification measures in place before a member's insurance cover can be cancelled.

23. In our experience it is not uncommon for superannuation funds to have an incorrect address or contact details for their members. Something more than merely sending mail should be required to ensure that all reasonable steps have been taken to warn a member before their insurance cover is cancelled.

24. In addition, while we believe it is good public policy to consolidate superannuation accounts when a member has an inactive account, it is also important to ensure that adequate protections for consumers are provided.

25. It is well accepted that many superannuation funds across Australia have vastly different insurance arrangements. For many, a TPD benefit is a single lump sum. One super fund we are aware of pays the TPD benefit in annual instalments over six years. Some other super funds do not pay a lump sum, but instead pay a long-term income protection benefit.

26. If a fund member is transferred from one fund to another, there is a risk that they could suffer significant prejudice by losing valuable insurance cover and be left with an active fund account that has inferior insurance. An insurance product may be inferior due to a lower amount of insurance cover, more expensive insurance cover or inferior/harsher definitions and terms.

27. Where any automatic consolidation occurs whereby the funds held in an inactive account are rolled into an active account the fund administering the active account should be obliged to ensure that the member is left no worse off due to the consolidation in terms of their insurance arrangements.

28. We recommend that a tiered rating system be developed so that consumers may understand the implications of the different TPD products. So, for example, a TPD definition with an Activities of Daily Living Test would be a rating 5 (the lowest score). A TPD policy

with a definition that matches the definition in the SIS Act would be a rating 1. That should be clearly stated in all statements and product disclosure materials, including in a Key Facts Sheet.[6]

Standard Cover – Obligation to Clearly Inform

29. One solution to some of the potential difficulties is to require all default funds to provide insurance cover with definitions that are consistent with the definition of Permanent Incapacity.[7] As is presently the case with general insurance products, an insurer may deviate from the standard definition only if they "clearly inform" the member.[8]

30. In terms of what constitutes "clearly inform", an insurer is currently deemed to have fulfilled their obligations if they have provided the insured with a copy of the product disclosure statement or policy.[9]

31. We recommend a strengthening of the obligation to clearly inform, such that the member is given a Key Facts Sheet as contemplated by the Draft Superannuation Code of Practice, which would include a prominent notice that the insurance cover differs from the standard definition or has a design other than a single lump sum.

Superannuation Code of Practice

32. The ALA agrees with the recommendation that it be a condition of a MySuper licence that the Fund must have adopted the Superannuation Code of Practice.

33. In addition, as has been canvassed in previous submissions to the Insurance in Superannuation Working Group, it is our view that the Super Code must be ratified by ASIC (including through compliance with ASIC's 'RG 183 Approval of financial services sector

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[6] See s33B Insurance Contracts Act.

[7] Reg 1.03C SIS Regulations.

[8] Section35 Insurance Contracts Act.

[9] *Max Hams v CGU Insurance Limited* 2002 NSWSC 273.

codes of conduct') and have external oversight from an independent code administrator with the power to impose sanctions for breaches of the code.

34. The ALA is concerned that the current Superannuation Code of Practice is voluntary, lacks any sanctions for breaches of the code and lacks any oversight from ASIC or a code administrator. From a consumer protection perspective, this is plainly inadequate.

Recommendations of the ALA

35. We welcome any future opportunity to engage with the Productivity Commission in relation to this important issue.

36. In summary it is our view that:

    (a) Trustees of default funds be allowed to exercise their discretion as to whether providing insurance cover for under 25s is in the interests of their members;

    (b) Further consideration/evaluation should be given to the impact of account consolidation measures and the resulting change in members Eligible Service Date and the tax implications that follow for people with a disability. Specifically, where any automatic consolidation occurs whereby the funds held in an inactive account are rolled into an active account, the member's tax liability upon permanent incapacity in respect to the funds held in the active account ought not be calculated using the ESD of the inactive account.

    (c) Insurance cover should be cancelled for inactive accounts where no contributions have been made for 13 months, and where adequate notification to the member has occurred;

    (d) Where any automatic consolidation occurs whereby the funds held in an inactive account are rolled into an active account, the fund administering the active account should be obliged to ensure that the member is left no worse off due to the consolidation in terms of their insurance arrangements.

    (e) Section 35 Insurance Contracts Act should be amended to extend the concept of standard cover to include TPD insurance, and to provide a standard definition as contained in the SIS Act. Trustees and insurers should be required to clearly inform their members should they wish to deviate from the standard cover;

(f) It should be a condition of default fund status that all MySuper fund Trustees be signatories to the Superannuation Code of Practice, and the Code should be ratified by ASIC (including through compliance with ASIC's 'RG 183 Approval of financial services sector codes of conduct') and be governed by an external independent code administrator with powers to sanction.