Navigating life together

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<table><tr><td>Mr Peter Harris AO<br>Chairman<br>Productivity Commission<br>Locked Bag 2, Collins St East<br>MELBOURNE Vic 8003</td><td>Ms Karen Chester<br>Deputy Chair</td></tr></table>

Dear Mr Harris and Ms Chester

**Superannuation: Alternative default models**

We refer to the Productivity Commission's Draft Report in relation to Superannuation Alternative Default Models (Draft Report) and welcome the opportunity to make this submission.

MetLife Insurance Limited (MetLife), an affiliate of MetLife, Inc., is a specialist provider of life insurance to affinity partners, superannuation trustees and employers in Australia. MetLife has expertise in designing and executing direct insurance programs for partners' customers and insurance solutions to meet the needs of specific member groups. MetLife has been a specialist provider of life risk insurance products in Australia since 2005. MetLife, Inc. (NYSE: MET), through its subsidiaries and affiliates, is a leading global provider of insurance, annuities and employee benefit programs. It holds leading market positions in the United States, Japan, Latin America, Asia, Europe and the Middle East

MetLife wishes to comment on a number of aspects of the Draft Report as follows:

- The role of insurance in superannuation;
- The first timer principle;
- The four proposed models; and
- Maintenance of the model.

**The role of insurance in Superannuation**

MetLife strongly supports the critical role of life insurance in superannuation.

Insurance in superannuation provides millions of dollars of benefits to members of the Australian community each year. These benefits can be transformational for people who are faced with injury, serious illness or the death of a family member.

We note that the Draft Report does not specifically address the role of life insurance in superannuation and makes the point that "it should be self-evident …that the Government's stated objective for the superannuation system does not envisage insurance as an essential element of the system." The Government's stated objective for superannuation is "to provide income in retirement to substitute or supplement the Age Pension".

If a member is unable to work due to illness or injury, he or she will inevitability also lack the means to save for their retirement. As life insurance provides financial support in these circumstances, it is an important adjunct to the mandatory savings system provided by superannuation.

We therefore believe that the Government's stated objective is consistent with the current design of insurance in superannuation. Further it is consistent with the sole purpose test as set out in section 62 of the Superannuation Industry (Supervision) Act 1993 which envisages that insurance may be provided as an ancillary benefit.

The current system of insurance in superannuation has the following advantages:

- The pooling of insurance risk in superannuation funds means that life insurance in superannuation is highly efficient, with claims-payout ratios of approximately 80%, which are significantly above those of general insurance or other types of life insurance;
- it enables funds and their insurers to design products which are suitable for their members, based on groups of members with similar demographic characteristics such as average age, ratios of full-time to part time workers, male to female ratios and occupational categories;
- it helps to address the issue of under-insurance in Australia;
- it provides insurance benefits to people who may otherwise not be able to obtain insurance.

The Draft Report states that insurance will not be one of the selection criteria for default funds. Due to the critical nature of the role of life insurance, we believe that it needs to be one of the criteria used to select default funds.

**The first timer principle**

The Draft proposes four alternate models for default superannuation.

Each of the four models relies on the principle that a person can only become a default member once and will be able to transfer their superannuation to subsequent roles. This will be facilitated by a government-supported database.

The pricing of insurance is in part based an actuarial view of the average age of the fund population over the term of the life insurance contract. The first-timer principle will impact on the sustainability of reasonably priced insurance because funds that are not successful in becoming short-listed funds will have increasing average ages, which will cause a significant impact on the cost of insurance.

In addition, the first timer principle will lead to a concentration of membership in a number of large and rapidly growing funds. In order to offer insurance to these funds, the insurance and reinsurance markets will need time to adjust to the capacity and capital challenges associated with such large funds.

The Draft Report opines that this first-timer principle will not cause significant disruption in the industry as it will only affect new members from the date of the implementation of any new regime. While we support initiatives that reduce the proliferation of multiple superannuation accounts, we are of the view that there is a risk that the first-timer principle will lead to significant disruption. This is because the administrative impact of dealing with a larger number of new members will fall onto a smaller number of funds who will need to have the systems, processes and resources in place to manage this increase.

Conversely, for many other funds, the number of new members will significantly decrease, leading to negative growth rates, as existing members leave the superannuation system. The risks associated with shrinking funds are well-known and include liquidity issues, investment management risks and tax issues.

Therefore, there will need to be an appropriate lead time for the introduction of the new system to manage the transition in an orderly fashion.

While we recognise problems associated with multiple superannuation accounts, we submit that the solution needs to be proportionate, and that this is a reducing problem due to a number of initiatives in recent years including:

- the increasing of the threshold for lost member accounts to $6000;
- the requirement that accrued default amounts in non-MySuper funds be transferred to a MySuper fund by 30 June 2017;
- the mechanisms available to funds to assist members to consolidate their superannuation accounts using SuperMatch and SuperStream.

**The Four Proposed Models**

The current superannuation system has the effect of grouping members broadly in accordance with the industry within which they are employed.

This supports the risk assessment of superannuation funds for insurance purposes, as their member populations have generally consistent demographic characteristics (occupation, age, gender etc).

Both Model 3 (shortlist based on selected criteria) and Model 4 (auction based on fees) involve the sequential allocation of members to default funds. Sequential allocation is essentially a randomised method of allocating new members.

This would make risk assessment for life insurance purposes very difficult, at least in the early years of implementation. The result is likely to be that the cost of insurance would increase and that there would be reduced access to life insurance. We are concerned that Model 3 or Model 4 would impact on the sustainability of insurance in superannuation for default members.

MetLife therefore submits that the preferred model for members as well as the broader community would be Model 1 (nudged employee choice) or Model 2 (assisted employer choice), or a combination of these two models.

**Maintenance of the preferred model**

Whichever model is ultimately selected as the go-forward model, careful thought will need to be given as to how the model will be maintained and what happens to members of a fund that ceases to be eligible for default status. It would not appear to be in the best interests of members that they remain in a fund which has lost its default status due to increasing fees or declining services, especially as each member can become a default member only once.

Ceasing to have default status and not being eligible to admit new default members would also have an adverse impact on the cost of insurance in that fund, as the average age of the fund membership will increase.

Please contact me or Cathy Duloy, Head of Public Policy should you wish to discuss any aspect of this submission.

Yours sincerely

Deanne Stewart
Chief Executive Officer