PRODUCTIVITY COMMISSION

DRAFT REPORT

SUPERANNUATION: ASSESSING EFFICIENCY AND COMPETITIVENESS

SUBMISSION BY PRIME SUPER

DATE: 13 JULY 2018

BACKGROUND:

The Productivity Commission report "Superannuation: Assessing Efficiency and Competitiveness" that was released in April 2018 contained a number of observations of the industry and made a number of recommendations on how to improve the system.

The key points noted from the review are

- *Australia's super system needs to adapt to better meet the needs of a modern workforce and a growing pool of retirees. Currently, structural flaws — unintended multiple accounts and entrenched underperformers — harm a significant number of members, and regressively so.*
  - *Fixing these twin problems could benefit members to the tune of $3.9 billion each year. Even a 55 year old today could gain $61,000 by retirement, and lift the balance for a new job entrant today by $407,000 when they retire in 2064.*
- *Our unique assessment of the super system reveals mixed performance.*
  - *While some funds consistently achieve high net returns, a significant number of products (including some defaults) underperform markedly, even after adjusting for differences in investment strategy. Most (but not all) underperforming products are in the retail segment.*
  - *Fees remain a significant drain on net returns. Reported fees have trended down on average, driven mainly by administration costs in retail funds falling from a high base.*
  - *A third of accounts (about 10 million) are unintended multiple accounts. These erode members' balances by $2.6 billion a year in unnecessary fees and insurance.*
  - *The system offers products and services that meet most members' needs, but members lack access to quality, comparable information to help them find the best products.*
  - *Not all members get value out of insurance in super. Many see their retirement balances eroded — often by over $50,000 — by duplicate or unsuitable (even 'zombie') policies.*
- *Inadequate competition, governance and regulation have led to these outcomes.*
  - *Rivalry between funds in the default segment is superficial, and there are signs of unhealthy competition in the choice segment (including the proliferation of over 40,000 products).*
  - *The default segment outperforms the system on average, but the way members are allocated to default products leaves some exposed to the costly risk of being*

defaulted into an underperforming fund (eroding over 36 per cent of their super balance by retirement).
  - *Regulations (and regulators) focus too much on funds rather than members. Subpar data and disclosure inhibit accountability to members and regulators.*
- *Policy initiatives have chipped away at some of the problems, but more changes are needed.*
- *A new way of allocating default members to products should make default the exemplar.*
  - *Members should only ever be allocated to a default product once, upon entering the workforce. They should also be empowered to choose their own super product by being provided a 'best in show' shortlist, set by a competitive and independent process.*
  - *An elevated threshold for MySuper authorisation (including an enhanced outcomes test) would look after existing default members, and give those who want to get engaged products they can easily and safely choose from (and compare to others in the market).*
  - *This is superior to other default models — it sidesteps employers and puts decision making back with members in a way that supports them with safer, simpler choice.*
- *These changes need to be implemented in parallel to other essential improvements.*
  - *Stronger governance rules are needed, especially for board appointments and mergers.*
  - *Funds need to do more to provide insurance that is valuable to members. The industry's code of practice is a small first step, but must be strengthened and made enforceable.*
  - *Regulators need to become member champions — confidently and effectively policing trustee conduct, and collecting and using more comprehensive and member-relevant data.*

ABOUT PRIME SUPER

Prime Super is a nationally operating industry styled superannuation fund with a large cohort of members located in regional and rural Australia and a separate division that services members within the health and aged care sectors. Prime Super is a not-for-profit industry fund, meaning that the Fund is run only to benefit members. Prime Super has approximately 115,000 members, more than 35,000 contributing employers and circa $4.0 billion in assets under management (as at 30 June 2018).

Prime Super offers members many benefits and services including:

- a choice of ten different investment options in the accumulation phase;
- a pension product that also offers ten different investment options;
- a range of competitive, flexible and cost-effective insurance options;
- low fees;
- website for members and employer services;
- free nationwide education seminars; and
- access to financial planning services.

Prime Super has a large number of members that are employed in a range of occupations in rural and regional locations as well as through the health and aged care sectors. The membership profile of the Fund leans towards blue collar / manual workers. Death and TPD (total and permanent disability) insurance cover is provided based on the occupations of those lives that are insured, blue collar workers typically have more risky occupations and therefore the cost of insurance for those persons will be higher than for a white collar worker.

Prime Super has a unique ownership structure where the Members of Prime Super own the Fund through a Nominee company. The Trustee is truly independent, it has five independent directors, and appoints one director as nominated by each of the NFF and the AWU.

EXECUTIVE SUMMARY

The key points of this submission are:

- The recommendations from the report will lead to a highly concentrated industry that will not deliver the best outcomes for members. As we are seeing through the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry a highly concentrated industry leads to weakness.

- From an investment strategy point of view Funds will either converge on the same asset allocation to ensure they are in contention to be on the 'best in show' short list, or will move to extremes to boost performance so aiming at being in contention for consideration to be on the shortlist.

- Funds will move further away from direct consideration of what is the best interests of their members to a position that is solely aimed at being in line with the market.

- Insurance is a 'cost' to superannuation accounts, but it is a long term benefit to the net outlay of a Government. That is short term welfare payments can be met by insurance rather than the Government's welfare system.

- Reducing the pool of members covered by insurance will lead to an increase in cost for all members and a reduction in benefits received. In the event that the current pooling arrangement is reduced the Government will inevitably be required to mandate certain levels of death and TPD insurance cover for individuals as is currently the case with the private health insurance surcharge.

- In relation to the insurance changes Prime Super submits that:
    1. The proposed changes will adversely impact many of its members and/or their families.
    2. The proposed changes introduce added complexity into the superannuation system that will result in members being either uncertain/unaware of their entitlements.
    3. The proposed changes will have the result of increasing the overall cost of insurance for members who "opt in".
    4. The proposed changes have the potential to increase the cost of the administration of superannuation accounts resulting from increased complexity.
    5. The proposed changes in some instances are clearly not in member's best interests and would put the trustee at odds with its obligation to always act in members best interests.
    6. The proposal requires additional input from and consultation with the industry to ensure that the risk of unintended consequences is reduced, the interests of all members are considered and the issues of account duplication, account consolidation and balance erosion are addressed satisfactorily.

- The transfer of accounts to the ATO will not solve any problem. It will remove insurance cover from a group of members that will more than likely not have any cover anywhere else. The outcome will be a higher cost to the current welfare system with no benefit to the long term pension liabilities of the Government.

- There is a conflict for Funds in the establishment of an investment strategy that delivers a return in the best interests of the members of the Fund and the need to have a market competitive investment return. The market views returns based on a league table approach, but the returns for Funds should vary according to the underlying membership.

- Disclosure of costs needs to be considered on a net basis, that is, what has been added to a members account through interest and what has been deducted through fees. Fees should not be considered in isolation as it can lead to an incorrect assessment of the performance of a Fund.

There is a deserved focus on improvement in the superannuation industry, but consideration must be given to the fact that the industry is not yet a mature industry, no person has been in the system for their full working life and contributing 9.5% of their income, so the retirement benefits accumulated cannot be seen as yet being anywhere near where they will be in the future.

Whilst cost is an important focus, it is more appropriate to focus on net member returns, that is investment fees net of investment costs. This is a true measure of the success of the strategy.

The heart of the problem is not that the industry has not being trying to engage with members it is that the benefit a member receives is not something they can see. Superannuation doesn't become real to most people until they are middle aged and have family commitments and start considering the long term. Superannuation funds cannot solve this "problem", the education system needs to teach students the basics of superannuation, so that when these individuals start working they have some level of understanding. Simply restricting competition for those first starting out in the workforce will create its own problems.

THE SUPER SYSTEM IN GENERAL

A summary of the draft recommendations that relate to the superannuation system in general:

> *Draft Recommendation 1*
>
> *Default super should only apply once, upon first entry into the workforce. Any other change in employment should not involve default consideration. This is to be facilitated through the Government and ATO centralising online services.*
>
> *Draft Recommendation 2*
>
> *A short list of ten funds should be presented to all members who are new to the workforce, a "best in show shortlist". The ATO to embed this shortlist into the centralised online service.*
>
> *Draft Recommendation 3*
>
> *Independent expert panel to select the "best in show" shortlist. The process to be repeated every four years.*
>
> *Draft Recommendation 4*
>
> *Government to legislate to allow APRA to apply the MySuper outcomes text. Funds to obtain independent verification (to an audit level standard) that the outcomes test has been met.*
>
> *Funds that fail to meet these conditions - or persistently underperform (for five or more years) an investment benchmark tailored to their asset allocation by a material margin, as determined by APRA – should have their MySuper licence revoked*

High Level Comment

A competitive superannuation industry is one that is in the best interests of all Australians, and in the best interest of Australia as a whole.

As with any product or service offering within a democratic society competition is the thing that drives change and improvement. Competition ensures the best possible outcome for users, where competition is restricted or tightly managed the net outcome is always a negative for consumers.

The highly concentrated banking industry has led to poor outcomes for those dealing with banks, as has been evidenced throughout the Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industries. The creation of a highly concentrated superannuation system will inevitably lead to the similar problems in the future.

Whilst superannuation has been around since the late 1980's, the initial level of mandated contributions was very low being 3.0%. The mandated contribution rate was lifted over the

years, and it wasn't until 2002 that the rate actually hit 9.0%, with the current rate of 9.50% not coming into force until 2014.

The superannuation system is a long way from being a mature system. On the assumption that an individual will be working for forty-five years, then the first group of retirees to receive the full benefit of 9.0% contributions will not be retiring until nearly 2050. Contributions rates of 3.0% and 6.0% lead to the creation of a superannuation account at retirement, they will never help an individual create a pool of funds which will provide any meaningful support in retirement.

Specific Comments

The default nature of superannuation and the lack of engagement does lead to the creation of duplicate accounts. This is a systemic issue, it is not something that has been created by superannuation funds in general.

Once Off Default Status

The concept that an individual should only ever be faced with defaulting once is the ideal situation where every member knows which superannuation fund they have and have all required details at the time they change jobs.

The reality is that the majority of individuals do not know which superannuation fund they are with, with a few being able to recall their fund if prompted. The superannuation industry in general has been engaging with members and employers for close to thirty years, through all manner of means, such as: letter, direct engagement, website, mobile phone aps, and attendance at conferences, television/radio advertising and a multitude of other avenues. It is not that these avenues are not appropriate or do not send the right message in a digestible format, it is that individuals do not generally get interested in superannuation until much later in life, or at a point where some other factor drives engagement.

Prime Super has provided members with a membership card that is credit card sized and can be carried in a person's wallet, the same is now also available through a mobile phone ap. The means to have all required information available to members are there, the problem is members do not immediately deal with superannuation. When starting a new job an individual is more likely to just leave superannuation up to the employer, to "save the hassle".

Prime Super completed a member survey in April 2018 through EY Sweeney, this survey was of 1,774 members, and it found that 78% of members were "quite satisfied" with the fund, and of those that have used a service provided by the Fund 92% were satisfied with the service provided. The key point being that the services are available and once a member engages with the Fund they are satisfied. The key issue is, and always has been, in getting members to engage.

In the event that the system moves to a once off default environment, as is currently proposed, a large number of people when signing up for a new job will not know their fund's details. It will then be up to the employer to determine where those contributions are paid. So although the formal nature of a one off default fund is in place, in practice nothing will change and the employer will be required to direct contributions somewhere.

The only practical solution is that the ATO allocates a member to a default superannuation fund at the time of issuing a tax file number ("TFN"). In this way the TFN and superannuation member account become synonymous. This would be a dangerous situation to have as the ATO would in effect be providing some form of approval of a fund to which default contributions are to be made, which it could never do.

Best in Show Shortlist

The concept of a best in show short list is inherently destabilising.

As is currently being witnessed through the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry a highly concentrated banking industry is not in the best interests of Australians, and leads to poor outcomes. By following the same route and having a small number of very large superannuation funds the same weaknesses are recreated.

Default membership is a key driver in the ability of a superannuation fund to grow. If the ability to grow through default membership is confined to a small number of superannuation funds, then competition to be on the shortlist will drive behavior that will not be in the long term best interests of superannuants.

Where competition revolves around a superannuation fund getting onto the "Best in Show Shortlist" the outcome is one or the other of these two options:

- All funds converge on the same investment strategy, so there is little chance of underperforming the funds included on the short list; or
- The only real alternative is to take a high risk investment strategy with the intention of significantly outperforming the competition so creating the possibility for inclusion on the shortlist;

This second strategy above is then the only viable alternative for those funds not on the short list to attract new members by enticing them away from the short listed funds.

Both these strategies are destabilising for the system as a whole. Both will lead to worse long term outcomes for the majority of those invested in superannuation, which will increase the pension burden for the Government.

This fact should also be considered in light of the Productivity Commission's statement that persistent under performance is measured over five years or more. Superannuation has always been considered as a long term investment, which for an individual is over their entire working life of forty to fifty years. ASIC requires comparison over a ten year period, and now the Productivity Commission is recommending comparisons be made over five years. Any one year of underperformance will place a high risk on the fund being able to deliver a competitive five year return. This will further drive funds to similar investment strategies as the risk of underperformance over a one year period is too great.

When combining these two measures: there are ten funds that have access to new members though default arrangements all other funds compete for existing members, competition to be one of the select ten funds is high with funds chasing high returns to either remain on the shortlist or to attract members away from the shortlist. Investment focus is now solely on

short term high performance, there are no long term considerations of what is in the best interests of members.

The current environment allows for variability between funds, which leads to a more robust superannuation environment. Those funds with a younger cohort of members can legitimately chase higher returns through riskier assets, as there is a longer investment time frame in place, and those with an older cohort of members will have a different approach. A simple head to head comparison of returns means Funds are not performing in the best interests of their members but in order to compete on a league table.

Short Term Investment Focus

An investment in superannuation is essentially a long term investment across an individual's working life, and then for a period of twenty odd years in retirement. This in theory is an investment timeframe of between fifty and seventy years.

Members have the ability to change superannuation funds at any time, therefore ratings agencies and commentators in general compare the investment returns declared and use this to rank superannuation funds. ASIC requires the publications of returns over a ten year period, and the Productivity Commission is suggesting returns that underperformance is measured over periods of five years or more.

Increased flexibility for members and more reporting of returns leads to the shortening of investment timeframe, which is leading to a reduction in the ability of Funds to truly invest for the long term. This has an impact of the real outcomes for members.

Ratings Agencies

Specific focus should be provided to reviewing and regulating ratings agencies. The number of ratings agencies has proliferated over recent years all purporting to offer a real means of comparison between funds.

The logic of how a rating is determined is not up for scrutiny, nor is the variation between agencies understood. There is no independent validation as to the accuracy of any rating provided. It is also not clear how independent the ratings process is, which leads to a high risk of the whole process being compromised.

The issuing of a rating on a Fund is a form of financial advice to members. The current process of providing this advice is totally unregulated.

Ratings agencies do not provide a balanced assessment, in general, advice is provided based on a simple comparison of cost. Insurance is a key area where the advice provided does not provide the full picture. Ratings agencies typically compare the premium per $1,000 of insured benefit received, with the cheaper offering being rated more highly. Little consideration is given to the detailed terms and conditions, as in insurance it is possible to have a very low premium but the conditions may be so tight that it is very difficult to ever get a real insurance benefit. Such a product will be rated highly based on cost but in reality it is not a good product for a member.

INSURANCE IN SUPERANNUATION

A summary of the draft recommendations that relate to insurance is as follows:

> *Draft Recommendation 14*
>
> *Insurance to be provided to those under the age of 25 on an opt in basis only.*
>
> *Discussed elsewhere in this report.*
>
> *Draft Recommendation 15*
>
> *Insurance to cease on accounts with no contributions for 13 months.*
>
> *Draft Recommendation 16*
>
> *Funds to articulate the account balance erosion determination (in relation to group insurance) they have made on a website and in the annual report.*
>
> *Draft Recommendation 17*
>
> *The ISWG COP of practice should be mandatory.*
>
> *Draft Recommendation 18*
>
> *Government to establish a taskforce to advance the Insurance code of practice, and make it binding.*
>
> *Draft Recommendation 19*
>
> *The Government to commission a formal independent review of insurance in superannuation to examine the costs and benefits of retaining the current system or a change to an opt-in system.*

High Level Comment

The key high level points that should be noted are:

- insurance is only included in superannuation because it is required to be offered by law;
- every dollar of premium deducted from a superannuation account works against the accumulation of retirement savings;
- superannuation funds are compared based on their insurance arrangements, which may override any superannuation considerations; and
- without insurance in superannuation a significant portion of the Australian population will have no insurance coverage.

Considering the implications of removing default insurance cover in superannuation it is clear that an increased number of persons will not have cover, which will place a greater burden on the public purse.

It is also accepted that a number of members may have their superannuation account eroded to nothing. But these same members will never accumulate sufficient superannuation to fund their retirement, and whatever is accumulated at retirement will simply be spent as soon as it is available. By removing insurance in superannuation the Government will continue to have the long term pension liability for these members, but will also have the short term cost of funding any disability or other claims on the public welfare system.

Specific Comments

The only reason that insurance is included in superannuation is that it is required by law Insurance has nothing to do with superannuation, therefore it should be removed from superannuation.

By law a superannuation fund must provide a minimum level of opt out death cover to members of the default MySuper offering. The required level of insurance cover is:

Age Range	Level of Insurance in respect of death
From 20 to 34	$50,000
From 35 to 39	$35,000
From 40 to 44	$20,000
From 45 to 49	$14,000
From 50 to 55	$7,000

Alternatively a superannuation Fund can offer insurance cover with a minimum weekly premium of $0.50 (or its equivalent) for persons under the age of 56.

Insurance is driven by the individuals that are included in the insurance arrangements. Where group insurance cover is in place, then occupation is a key driver in the terms of the insurance arrangements. For example, a pool of members that are blue collar young males will have a different claims profile compared to a pool of members that consists of older office based females.

Industry funds have been established on the basis that they provide a service to a particular industry, and therefore the pool of members in the Fund will have characteristics that distinguish it from another pool of members.

The proposed measures are to prevent Trustees of superannuation funds from providing opt out insurance to members:

- who are new members and under 25 years old;
- with an account balance below $6,000; or
- with an account that has been inactive for 13 months.

Addressing each of these groups in turn:

A new account for a member who is under 25 years of age

A superannuation fund's primary responsibility is to enable individuals to save enough through their superannuation account to either fund their retirement, or provide a supplement to the age pension. Superannuation funds are also required by law to provide a level of death and TPD (Total and Permanent Disability) insurance cover to members. Trustees are aware that any insurance premium deducted from a member's account will lead to a lower superannuation balance over time.

A Trustee is responsible for having an insurance management framework that reflects the risks associated with making available insured benefits that are appropriate to the size, business mix and complexity of the Fund's business operations. In addition Trustees are responsible for ensuring that the insurance offering by the Fund is appropriate for the needs of the members of a Fund.

Prime Super has a large number of members that are based in rural and regional Australia. Those that live in rural and regional Australia are more likely to leave school, take up employment and have familial commitments at a younger age than those that live in the major urban areas.

Prime Super understands the need to match insurance needs with default offerings. However, we consider that the proposed change will leave many Australians who have financial commitments or family commitments with no insurance cover.

The Australian Government's Australian Institute of Health and Welfare report "Australia's mothers and babies 2015 – in brief" report notes that the average age of mothers is increasing. The number of babies born to those women under the age of 25 accounted for 15.3% of births in 2015 (19.0% in 2005), however the actual number of births to that age group has only decreased slightly with 46,553 births in 2015 (50,881 in 2005). This indicates there are a significant portion of the population with familial commitments under the age of 25, who will likely have no insurance cover as a result of these changes.

Whilst it is accepted that there is a view that superannuation funds should do more to engage with members under the age of 25, it is easier said than done. Superannuation is a complex financial product that is not understood by a large section of the workforce, the system has been in place for thirty plus years and it is clear that there is no easy way to engage a twenty one year old with their super, let alone the insurance aspects of that superannuation account. Default insurance was introduced to provide protection for those that don't realise they need it. It is only at the time of making a claim that the majority of superannuates understand the benefit of the insurance aspect of their superannuation fund, this is particularly true for younger Australians.

If this measure were to be introduced there would potentially be 45,000 young families that do not have any death and TPD insurance protection.

The second aspect of insurance cover for young members relates to the need for TPD cover. Even if these young individuals do not have a familial commitment there does remain a need for TPD insurance cover. It can be argued that death cover is not required for young persons, but a young working person does need TPD cover. In the event of an incident that leaves an individual totally or permanently disabled without cover through a superannuation fund, the

cost of this incident will fall solely on the welfare system. The cost of insurance through group insurance arrangements provided by superannuation funds leads to a lower cost of insurance for members, particularly where it is tailored for certain groups of members, and a better outcome for all Australians through a reduced burden on the welfare system. This system is a far more cost effective way of managing the insurance needs of working Australians.

Prime Super has reviewed claims data for the last two years, and notes that 2.2% of all claims relate to members under the age of 25. Of the total membership of the Fund around 5% are under the age of twenty five. Therefore insurance claims for those under the age of 25 are only marginally underrepresented in the claims data. A move to remove cover for younger members would not be in the best interests of the members of the Fund.

Most members under the age of 25 do not make a claim on their insurance through superannuation, some do, and the following table lists a few brief examples of members under the age of 25 that have received a benefit from their insurance arrangements through Prime Super:

Under 25
Member 1 22 year old, lightning strike $13,291.81 Account balance $95,200 Insured component Defacto spouse
Member 2 21 year old, multiple injuries $8,155.68 Account balance $90,000 Insured component No dependants (estate)
Member 3 19 year old, crushed by a bull $120.42 Account balance $95,200 Insured component Interdependant mother

The dependents where applicable receive a real benefit because of the default insurance arrangements that are in place for these young members.

An account that has been inactive for 13 months

The provision of group insurance arrangements that were based on the receipt of contributions (that is cover was only in place whilst contributions were being made) was a common arrangement in place in the industry up until about the early 2000's. This then gradually changed to a situation where insurance continued to be offered as long as there was money in the individuals superannuation account.

The move away from contribution based cover was driven by a number of issues that will remain as issues today should the industry return to this basis for providing its members with Death and TPD cover.

- Members' insurance cover may be cancelled as a result of employers failing to pay SG payments as required. Prime Super has approximately 35,000 contributing employers. Many Prime Super members work in temporary or casual jobs and do not review contributions being made, simply assuming that employers are meeting their obligations.

- The proposed legislation sets out the criteria for reminders to be sent to members that their insurance cover is about to cease. Whilst some members may take action a majority will not as the matter is either not understood or they see no value in insurance. This will lead to reduction in the number of persons with cover.

- Prime Super has a high exposure to individuals that work on a contract basis. Any individual that has such broken work patterns may in fact see a number of letters under the proposed legislation, and may pay attention to the first few letters, but over the years they will be ignored and insurance cover may then cease, even though there was never an intention to let it happen.

- If cover ceases as noted above it will not be possible to simply reinstate cover as those that are seeking to reinstate cover are more likely to be those that require cover, i.e. a higher insurance risk. It will therefore be necessary for each of these members to be individually underwritten. It is well established that a higher number of members will not proceed with applying for insurance if an underwriting process is required, even if it is a simple process. The loss of a default nature of insurance will reduce the number of members that have cover.

- As insurance will be provided based on contributions received into the Fund there is a greater likelihood that members believe they have insurance cover when in fact they do not. The most recent statement received by the member (effective at June and December each year), may state that cover is in place, but by the date of the incident members may have had their cover cancelled. This information is clearly available to members through websites. But lawyers will take up the matter and complaints around whether insurance is in place or not will increase and will be heard through the courts. This will have a further cost impact on insurance and superannuants.

- The requirement for all members to "opt in" is difficult to understand. There are a small number of members who have taken some action with their insurance, increasing it, moving from unitised to fixed cover or simply change occupational status. The vast majority of members do not read what is sent to them and do not engage with their superannuation fund. Even with increased notification to affected members, the vast majority of those that should opt-in will make no decision, and will therefore have no insurance cover.

- Those members that have taken some action with their insurance, increasing it, moving from unitised to fixed cover or simply change occupational status have made an active decision around their insurance and as such should not be impacted by these changes.

- The period of 13 months for establishing "inactivity" is too short. There are many reasons for members reaching this time line and not being "inactive".
  - Members taking extended family leave
  - Members taking career breaks to travel
  - Members who work in seasonal occupations who miss a season (maternity/paternity or travel break)
  - Members taking an extended break as a result of injury or illness

  It is recommended that this time frame if introduced be extended to a 24 month period.

An account with a balance below $6,000

The argument that an account with less than $6,000 should not have insurance premiums deducted from them is not reasonable.

A key aspect that is not considered in the determination of the $6,000 cut off level relates to an individual's circumstances. For example, a 45 year old individual that has one superannuation account with $5,000 in it is best served through having insurance deducted from the account:

- The size of the account indicates that they are unlikely to be in a form of employment that would ever result in the account accumulating a significant balance at the time of retirement;
- Any monies that were accumulated in superannuation up to the point of retirement would simply be spent at the time they could be claimed. Therefore this account has served no benefit in providing a retirement solution for this individual. The Government will bear the full cost of a pension for this individual;
- As the account balance is low, it is highly likely the individual has broken work patterns and is unlikely to have insurance in any form.

In this hypothetical instance if insurance cover were to be cancelled the Government would still be required to pay the full cost of pension entitlements, as well as being at risk for any welfare payments should an event that leads to total and permanent disability occur. By retaining insurance cover for this members the Government has a reduced exposure for any event that leads to total and permanent disability.

Additionally, members are encouraged to consolidate their super. In the event that this member does have another small superannuation account somewhere else, it is likely that that account will have insurance as well. This is actually a positive, as is reported by Rice Warner there is chronic under insurance within Australia, the fact that a member has two default insurance arrangements, that are both claimable leads to a better net outcome in the event of death or disability.

Other specific points of note:

- Insurance is currently developed based on a lifetime membership basis. That is a member joins the Fund when they start work and have cover throughout their working life. Insurance costs are spread over the lifetime of membership. Yes the costs are higher in the first few years (as a percentage of the account balance), but significant benefits flow later in life. The cost of insurance will increase to cover the fact that the period that insurance is being taken out for is reduced. Very simply this means that if

default cover is provided at $4 per week over a forty five year working period (i.e. age 20 to 65), then, if the working period is reduced to forty years (i.e. age 25 to 65) everything else being equal the cost per week will increase to around $4.5 per week.

- This change effectively removes insurance cover for all members joining the fund until their account balance reaches $6,000. This leads to a period of time where no insurance benefits are provided. Insurance cover will be required to commence on a default basis to ensure there is no selection against the insurer, (i.e. the majority of those individuals that will choose to take out insurance cover will be those that require death and TPD insurance will apply, that is terminally ill persons for example). Others will not apply.

- The recommencement of insurance at $6,000 will create the same problem that is being addressed, that is members do not want insurance and therefore make a complaint about the fact that insurance has started without their permission. All members are currently advised at the time of joining the fund that they have insurance cover and can cancel it if they wish.

Prime Super has reviewed its claims data for the last two years. The results show that 38% of Death, TPD or Terminal Illness claims paid were to members with account balances under $6,000. 41% of all members of Prime Super (both those making contributions and those inactive members) have an account balance of less than $4,000 therefore the number of claims made is representative of the total membership of the Fund.

These are members and or their families who would be severely disadvantaged by the implementation of these proposed changes. Without that insurance payment there is the heightened risk that those claimants would have had to seek welfare assistance from the Government. We strongly recommend that this proposal should be removed as it will severely disadvantage Australians and their families and lead to a greater welfare system cost to Government.

Opt In Insurance Arrangements

Comments have been made that superannuation funds simply need to engage better with their members and encourage members to take out insurance, or increase insurance cover, or make investment decisions. These comments are easy to say, but fundamentally all superannuation funds have been focused on increasing engagement with members for many years. Full and positive engagement is not realistically possible because:

- Superannuation is a long term investment that is not tangible to most individuals until they are nearing retirement;
- Superannuation is a complex investment product in which the majority of Australians will never be adequately equipped to understand at the point of joining the workforce;
- Superannuation is a highly regulated industry, it is not possible to have a simple conversation with a member about how to use superannuation best.

GENERAL COMMENTS

There is a mistaken assumption that members with inactive accounts and small account balances should not bear the cost of the superannuation system. Every account balance,

whether it be for an amount of $1 or $1 million has the same obligations around it, a superannuation fund is required to, amongst other things:

- Maintain all details of the account including any and all transactions;
- Formal annual statements are to be sent to, or available to, the member each year;
- Communications are to be sent to the member to inform them of the product and any changes that have been made;
- All accounts bear the cost associated with all levels of reporting through to all Regulators; and
- All members bear the cost associated with the payment of benefits to those members that leave the Fund (the proposal is that no exit fees be charged, therefore existing members must bear the transactional cost);

The Australian superannuation system is a highly regulated, complex and costly system. All members bear the cost of being a part of the system. The largest cost that is ever deducted from a members account is the 15% tax applicable to contributions (it typically takes around seven years before the accumulated superannuation account including interest exceeds the raw sum of contributions made to a fund).

General Insurance Requirements

Rice Warner has reported that in general Australians are under insured to the tune of approximately $1,811 billion. This is made up of under insurance in the main life insurance "categories":

- $57 million per year for life insurance
- $1,258 million per year for total and permanent disability (TPD) cover
- $260 million per year for income protection

Those with small account balances are more than likely to have their only form of life insurance cover provided through their superannuation fund. Removal of insurance cover provided through superannuation funds will lead to an increase in the level of under insurance in Australia, and will lead to a higher cost to the welfare system for this increased pool of members with no insurance protection.

Insurance Pool

The proposal to remove insurance cover for those with less than $6,000 in their account will reduce the number of members in the overall pool of insured persons. Over time this will result in an increase in premiums for members who have opted in to insurance arrangements.

The matter is not one related to any specific fund, the matter needs to be considered in totality. A reduction in the total pool of insured members will result in an increase in the cost of premiums, because the number and value of claims will remain unchanged.

Given this, there will not be a savings of insurance premiums as the Government is suggesting.

If the Government is concerned about the level of duplicate insurance that is currently possible, this concern is misdirected. As noted above by Rice Warner there is a significant level of under insurance within Australia. Those individuals with small account balances that do have duplicate superannuation accounts are likely to also be the ones that do not have

sufficient life insurance protection. Those individuals that are on top of their affairs will have one superannuation product and potentially the correct amount of insurance. Those that are not on top of their affairs benefit to a large degree through the additional level of default insurance cover they have.

Ultimate Solution

Whilst we do believe in the value that the insurance offering provides to the members of Prime Super, we do understand the intent of the changes, which is to improve the retirement outcome of Australians. To achieve this better retirement outcome, a radical change to the system, is required.

A superannuation fund is run to provide the best long term outcome to a pool of members of the Fund taking into account the risks associated with investing. Any deduction from a superannuation account will lead to a lower retirement benefit being available at the time of retirement. Insurance is occupationally based (that is higher risk occupations pay higher insurance premiums when compared to lower risk occupations), whereas superannuation is not. Superannuation is driven only by the contributions made to a superannuation account the fees charged and the earnings on that account.

The key thrust of the proposed changes is that the deductions taken out of member accounts are eroding the potential retirement savings of ordinary Australians. A significant component (often the second largest deduction from default superannuation accounts after tax) relates to insurance products that are provided on a default basis to members of the Fund.

Superannuation Funds are required by law to offer a minimum level of insurance cover to members of the Fund. When selecting an insurance offering to be provide to members a Trustee is faced with balancing the long term retirement needs of individuals with insurance protection in the event that a members dies or is disabled prior to reaching retirement age. As noted above Rice Warner has reported on the chronic level of under insurance in terms of life insurance products for Australians. Superannuation funds have established insurance offerings that meet the needs of their individual membership based on the occupational nature of the membership of the Fund.

The most appropriate solution to the concern around the high level of fees deducted from superannuation accounts is to separate retirement and superannuation needs of individual Australians. The two objectives do not sit naturally within a superannuation fund. Superannuation is about accumulating an amount of money by retirement age that can provide an income stream in retirement, whilst insurance is about providing cover now in the event of death or disability. These two objectives are diametrically opposed.

Given the above, insurance should not be mandated in superannuation. That is, no superannuation fund should offer insurance of any form. As a result all superannuation funds would therefore be competing solely to deliver the best retirement outcomes they can. In so doing there will be better clarity over investment performance and the cost of delivering the product, without the complicating factor of the type of insurance offered.

The complexities associated with the development and management of insurance products and policies will be removed from the system, and all members will get a better retirement outcome as a result of the removal of insurance premiums and the cost of managing the

insurance arrangements. The reduction in cost will therefore be a removal of the insurance premium itself and a reduction the other costs associated with insurance including the administration of the insurance arrangements.

By removing insurance from superannuation members will be better off because:

- Members will get a better retirement outcome through the removal of deductions for insurance premiums from their account;
- Communications with members will be clearer and more concise, as the product only relates to the investment and management of contributions made to a Fund and accumulated investment returns for the purposes of delivering a retirement outcome – so leading to lower costs in the system;
- Complex communications around insurance arrangements will not be required – so leading to lower costs in the system;
- The administration function around managing insurance arrangements will be removed – so leading to lower costs in the system;
- Complaints around inappropriate deduction of insurance premiums will be removed – so leading to lower costs in the system;
- Complaints around incorrect decision being made on insurance claims will be removed – so leading to lower costs in the system

If the Government is also concerned about the overall level of life insurance cover amongst Australians it would then be necessary to create a national life insurance pool that could be run in a similar way as superannuation. A basic insurance premium could be deducted from individuals' salary, like the way the Superannuation Guarantee contributions are currently deducted, but the premiums are paid to a pool or other body to provide the overall insurance product.

Comparison to Health Insurance

Consideration should also be given to the current health insurance environment in Australia. Currently an Australian citizen has to pay a surcharge through the taxation system if:

- they are a single person with an annual taxable income for surcharge purposes greater than $90,000; or
- they a family or couple with a combined taxable income for surcharge purposes greater than $180,000. The family income threshold increases by $1,500 for each dependent child after the first; and
- do not have an approved hospital cover with a registered health fund

Essentially the public health system has become increasingly unaffordable, and the Government is requiring individuals take out private health insurance cover (or pay a surcharge) to ensure the system is viable.

When this situation is compared to superannuation, where a significant number of individuals have death and TPD insurance cover, it is clear that where insurance is not compulsory (or default in nature) individuals will not take out cover. It is therefore reasonable to expect that over the years the number of members with insurance through superannuation will decline, which will lead to significant increases in premiums and eventually a similar surcharge being applied to ensure a minimum number of persons have cover.

REGULATOR OVERSIGHT

A summary of the draft recommendations that relate to insurance is as follows:

> *Draft Recommendation 8*
>
> *Cleaning up lost accounts. All lost accounts to be sent to the ATO, no transfers to ERF's and all ERF funds closed through a transfer to the ATO.*
>
> *Draft Recommendation 9*
>
> *A member friendly dashboard for all products to be published. The current dashboard to be simplified and provide more easily comprehensible metrics. All information to be published on a centralised website.*
>
> *Draft Recommendation 10*
>
> *The ATO to deliver dashboards on a members existing account, through the centralised online service, MyGov.*
>
> *Draft Recommendation 11*
>
> *ATO to guide all persons when they reach the age of 55 to the ASIC moneysmart website and DHS.*

Member Dashboards

There is no concern with publishing data, but it essential that like with like comparisons are made.

A key flaw in the current disclosures is best illustrated through a simple comparison. Consider a fund that owns shares in two companies, both of those companies then own direct property. The disclosure of the investment costs of each of these investments will depend on whether the company is listed on a stock exchange.

Where the company is listed on a stock exchange there is a requirement to disclose only those costs associated with holding, buying and selling the shares during the year.

Where the company is a private company there is a requirement to disclose:

- borrowing costs; and
- operating costs including:
    - asset management fees
    - valuation fees
    - office outgoings
    - car parking costs
    - accounting costs
    - tax costs etc.

Where a listed entity owns fifty percent of a building and a private entity owns the other 50% the listed entity will be reported as having a lower investment cost that the private vehicle even though it is an identical asset.

Inherent Bias in Current Fee Disclosure

The current fee disclosure regime has an inherent bias to index or low fee products over the net return generated. The fee table required in the PDS only considers fees levied and imputed investment costs, there is no correlation to investment returns earned.

Prime Super currently discloses a cost against the investment property option of 3.00% which includes a performance fee of 1.73%, by industry standards this is a very high cost. However, the investment return generated was 24.49% for the one year to 30 June 2017 and 23.74% for the three years to 30 June 2017. These returns are a long way ahead of the competition. The high investment costs are a negative, and yet the best outcome for members has been achieved.

Appropriate Measure

The only appropriate measure is to compare the net investment return that is all earnings less costs, in a form that shows what was added to a members account, and a comparison of what was taken out by administration costs. All investment costs must be included against investment returns, by isolating investment costs it simply acts to confuse and at worse mislead members in their decision making process.

By breaking the disclosure down to the simple measures of what has been added to a members' account and what has been deducted it is easier to compare between funds, and there is less opportunity to make the costs appear more "reasonable". The focus is then shifted to getting the best net outcome for a member, which is the core objective of the system.

Current Dashboard Reporting

The current dashboard reporting requires a different form of disclosure for investment returns and member fees than is reported elsewhere. This again leads to confusion with members not being able to understand what the real returns are. The current dashboard reports investment returns net of all costs, where a flat fee applies (such as $1.30 per member per week) this means every account balance will have a different net return.

By requiring reporting on this basis the information being provided to members is confusing and can be used in a way that delivers a poor outcome for members.

ATO TO RECEIVE ALL SMALL ACCOUNT BALANCES

The following draft recommendation has been made in relation to removing small account balances from the superannuation system:

> *Draft Recommendation 8*
>
> *Cleaning up lost accounts. All lost accounts to be sent to the ATO, no transfers to ERF's and all ERF funds closed through a transfer to the ATO.*

The concept that all lost or small accounts be transferred to the ATO is not in the best interest of members. Superannuation funds invest in a balanced mix of investments and over the long term have a higher rate of investment return when compared to the ATO that will pay a statutory rate if the Funds are claimed.

As noted previously in this submission, and account balance of $5,000 with insurance is a better option to the individual than having the money transferred to the ATO. Yes the account will not be reduced by insurance premiums, but over the longer term the superannuation fund will deliver a higher earning rate than the ATO will pay, and the member will retain insurance cover.

There is superior outcome to the individual through receiving insurance cover (that is claimed) on these small balances, as opposed to having them centralised with the ATO and insurance being removed. The superannuation benefit becomes meaningless at the point of retirement, but the fact that there is an insurance benefit attached to that account delivers a better long term outcome to the member. This is also a better outcome for the Government as the potential short term cost of welfare is improved without an impact on the long term pension obligations of the Government.

Transfers to the ATO

As noted in the insurance section of this submission the loss of insurance is a significant negative in the transfer of lost accounts to the ATO. The loss of the insurance benefit to those members that make a claim will now fall on the Governments welfare system rather than being covered by the insurance through a superannuation fund.

In addition the threshold being considered is for all inactive accounts below $6,000 being transferred to the ATO. Default insurance in Prime Super costs $4.44 per week, or $230.88 per annum. The member fees on an account of $5,000 amount to $92.60 per annum. Total fees deducted from an account of $5,000 amount to $323.59 per annum, which is equivalent to a return of 6.5% per annum. Prime Super's current seven year return for the MySuper option is 9.36% (Prime Super made significant changes to the investment strategy in 2009/10, and as such the ten year returns do not reflect the current investment strategy). On the same basis an account of $4,000 would be required to earn a return of 7.9% to cover the costs of insurance and administration, which in Prime Super it does.

There is therefore a strong argument to set the bar lower for amounts to be transferred to the ATO. Yes fees are being charged, including insurance, but in a large number of cases the interest being earned is more than enough to cover the cost of administration and insurance.

As noted in the insurance section of this submission the key risk in the transfer of small account balances to the ATO is the loss of insurance cover, as default insurance cover will be lost as a result of the transfer.

Even though many of those with small account balances will not make a claim on their insurance through superannuation, some do, the following table lists a few brief examples of members with low account balances that have received a benefit from their insurance arrangements through Prime Super:

Account Balance Under $6,000
Member 1 33 year old, suicide $4,100.68 Account balance $132,400 Insured component Defacto spouse, 10 year daughter and 2 adult step children
Member 2 47 year old, multiple organ failure $1,712.19 Account balance $73,200 Insured component Spouse, 5 children from ages 6-16
Member 3 40 year old, pending coronial inquest $722.64 Account balance $125,600 Insured component No dependants (estate)

Without insurance in superannuation for these small account balances the dependents of these members would be making a greater claim on the Welfare system.

As has also been noted earlier, an account balance of this size may never amount to anything at retirement, and if it is maintained by the ATO in most cases it will amount to less than what would be available from a superannuation fund. So the amount that is paid out at retirement will simply be spent by the member, and the Government will bear the full cost of the pension at some stage in the future. By keeping this amount in a superannuation fund with insurance, the long term cost on the Government will be better managed as there is a lower payment under the welfare system for those that would have made a claim on their insurance.

Conclusion

There will always be a large number of persons that do not work full time and therefore never make significant contributions to their superannuation fund. These monies will never accumulate to an amount that will provide any form of post retirement income. The full amount will merely be spent by the individual at the point of retirement, and then a Government pension will be drawn. The fact that insurance is taken out of these accounts is actually a plus for the Government of as short term welfare costs will be reduced.