11 September 2017

Superannuation Productivity Commission
Locked Bag 2
Collins St East
Melbourne VIC 8003

http://www.pc.gov.au/inquiries/current/superannuation/assessment

Dear Commissioners,

EFFICIENCY AND COMPETITIVENESS OF THE SUPERANNUATION SYSTEM

Productivity Commission Stage 3 Issues Paper

In this submission, we have focused on two areas of interest, as follows:

- We have provided some high-level commentary on the provision of life insurance through superannuation arrangements. The Institute hopes to engage further on this subject when the Commission releases its interim report.
- We have also provided detailed commentary on the issue of product dashboards raised in Stage 3 Issues Paper.

The Institute would be happy to assist the Commission if it requires further information regarding the matters raised in this submission or, if it would benefit from gaining actuarial insights into other aspects of the inquiry.

Insurance in superannuation

The Institute acknowledges that questions regarding the provision of life insurance through superannuation arrangements are valid but believe they should be viewed through the lens of efficiency when considering the benefits of a default mechanism.

Unfortunately, the debate about insurance in superannuation has focused purely on the costs (in terms of erosion of account balances) but it is important to remember that a valuable service is being provided to members (not just benefits paid, but the utility / "peace of mind" of having insurance in place).

Our initial view is that the existence of default insurance in superannuation is efficient for several reasons, including:

a. Purchasing power / scale benefits – the size of individual groups drive down the cost of cover so that group life returns 80-85c on every dollar spent in claims paid to members, which is the highest of any type of life and disability insurance distribution channel. The returns from other channels are typically, significantly lower;

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b. Reduced underwriting is a feature of group life in contrast to other channels. This allows higher risk and sometimes uninsurable individuals (such as heavy manual occupations and casuals) to be offered cover, very often at standard rates, while still providing good value cover to members with normal risks;

c. Coverage – Australia's life insurance penetration rates are among the highest in the world because of its distribution through the superannuation channel. Despite this, there is still an underinsurance gap but the superannuation system ensures that all working lives receive a basic level of cover, and developments in technology will allow for this to be increasingly tailored to individual's needs.

d. Provision of certain insurance benefits is consistent with the purpose of superannuation. Insurance coverage provides protection for members who through ill-health are forced into early retirement. More fundamentally the origin of superannuation itself was a policy response to old age disability.

Calls for removal of the current levels of coverage would remove coverage for millions of Australians and place an increased burden on government, primarily through increased social security payments. Rice Warner[1] estimates that removal of all default cover could impact the economy by $6B per annum. However, we do recognise that efficiency improvements could be achieved by making changes to existing policy design. This potentially includes removal of default cover for younger members.

It is important to remember that almost all the existing legal infrastructure/costs of evaluating disability and identifying and paying dependents would need to remain in place if insurance was removed from superannuation, as accumulated savings would still need to be distributed in the event of death and disability. Insurance in super efficiently utilises these existing processes to provide greater benefits to members.

Nevertheless, we believe there are some practical changes that can be made to improve the system and these are set out in Appendix A.

Dashboards and Disclosure

This section is based on an earlier letter headed "Product Dashboards and Disclosure" that was forwarded to Treasury on 8 November 2016 by the Actuaries Institute Superannuation Practice Committee. A copy of that submission was also sent to the Productivity Commission.

That submission reiterated our concerns about the effectiveness of the current superannuation disclosure regime. The Institute believes that it is important that superannuation fund members become aware of the deficiencies in the current MySuper Product Dashboards (and the planned Choice Product Dashboards). Additional information detailing our concerns about dashboards are contained in Appendix B.

[1] Rice Warner, Submission to the PC; Superannuation: Assessing Competitiveness & Efficiency August 2017

Although the issues covered in the above letter may appear technical and focused on 'dashboard' disclosures, they relate directly to the following broader concerns which may be exacerbated if the Commission's review prompts fund members to actively review their current default superannuation arrangements. Concerns include:

1. If there is an increase in the number of members reviewing their arrangements, inappropriate dashboards may be used more often as a comparative tool;
2. There are already many third-party comparison tools available to consumers, many of which simply pick up and display information available in the public domain, often sourced from dashboards or data published by APRA;

Another possible outcome of the Productivity Commission review may be the retention of the current 'default' fund structure but with funds being chosen by employers or a new established body based on standardised metrics sourced from dashboards or similar published sources;

In each of the above circumstances, our concern is that the metrics and comparison tools mandated by government should be technically sound, should not mislead consumers and as far as possible should assist decision-makers to reach a reasonable conclusion. By default, the current methodology underpinning dashboards (and other statutory disclosures) is likely to become the established and accepted approach for all future uses, so it is important to ensure that the current disclosure regime is placed on a firm foundation.

Conclusion

The Institute believes, for the reasons set out in this submission, that default life insurance should be retained within group superannuation for the benefit of the individual and community. However, the current policy settings around disclosure are inhibiting the competitiveness of the superannuation system. We have made specific suggestions and recommendations in the appendices, in relation to how policy settings for both insurance and disclosure may be improved. We are available to discuss these proposals with you.

If you would like any of these matters clarified or wish to engage further with the Institute please contact the CEO, Mr David Bell

Yours sincerely,

President

Appendix A – Specific Insurance Issues

As mentioned above, we support insurance being provided through superannuation on a default basis, and we set out below some suggested policy changes to further improve arrangements.

Erosion of account balances through multiple accounts having insurance

The problem of multiple accounts is well documented in your earlier paper, and recommendations include the use of the new Single Touch Payroll to facilitate account consolidation.

Of all the proposals to reduce account balance erosion, assisting members to rationalise the number of superannuation accounts is the single initiative that will have the most significant impact.

We believe that, with appropriate safeguards, insurance should not be a barrier to account consolidation. There is an opportunity to place important safeguards in the consolidation process by leveraging Single Touch Payroll via the online Super Choice form such as:

- For each fund shown – a tick to indicate whether the person has insurance benefits in that fund (next to the person's account balance)
- For each fund shown – the ability to view the sums insured for death, TPD and IP currently in place.
- A warning issued / acknowledgement required before the person's choice is activated with the following text:

"Consolidating your super may mean your insurance benefits will cease in your old fund. Your new fund may provide insurance, however, you should read the PDS to understand whether you will be eligible for cover, and whether that cover is appropriate for you. Do you wish to continue?"

The insurance information required to facilitate this arrangement could be provided through an extension of the SuperStream "Member information Exchange" (MiX). This information could then also be used in the ATO SuperMatch service or myGov to help members find their "lost" insurance.

Long claims delays – low levels of awareness

While it varies from scheme to scheme, the typical average delay in a TPD claim being notified to the insurer is around two years after the date of disablement. The delays for income protection claims are slightly shorter, but still significant. This has serious implications for return to work outcomes. It also leads to higher premiums than would otherwise be the case due to the uncertainty in estimating the ultimate claims cost.

The reasons for these long delays are many and varied, but chief among them are:

- Low levels of awareness of cover.
- A perception that life insurance benefits will jeopardise workers' compensation benefits.
- Reluctance of some employers to assist in the reporting process for potential (or perceived) liability in relation to work related incidents.

Suggested solutions (particularly to awareness and engagement) for consideration include:

- Utilising data from:
    - Employers (reporting sick leave data via SuperStream),
    - Workers Compensation insurers,
    - ATO and Department of Social Security,

  to notify trustees of superannuation funds of potential claims (via the ATO Supermatch service) to allow trustees to proactively contact members about their ability to claim.

- Inclusion of messages in the Workers Compensation claim process about the potential ability to claim superannuation benefits.

- Removal of regulatory barriers (including privacy law) for data sharing between Workers Compensation insurers and life insurers, where this may assist earlier notification of a potential claim to the life insurer.

- Considering a statute of limitations (and clarity in the Insurance Contracts Act) –to permit insurers / trustees to impose a time limit on claims lodgement.

TPD is not always the optimal benefit.

Section 68AA of the SIS Act requires the trustees of funds to provide a permanent incapacity benefit (i.e. a TPD) to MySuper members. There may be many reasons why a trustee might consider an income protection preferable as default benefit instead of TPD. Income Protection might better meet member needs, provides an easier and faster assessment including encouraging return to work and the ongoing contact is better at dealing with mental illnesses and avoiding members medicalising problems due to the significant lump sum payout.

We recommend that there be clarification that the current SIS Act 68AA allows trustees the discretion to offer either a lump sum or income benefit to members that meet a TPD definition. If this is not the case, then 68AA should be amended to allow that discretion. We would welcome further discussion with the Commission to ensure that the appropriate benefits for members can be provided.

Appendix B - Specific Dashboard issues

The Issues paper states, with our bolding added for emphasis:

Key evidence needs and priority areas for submissions

A threshold evidence issue for the Commission relates to the effect of policy settings on system performance. As noted above, the stage 1 report deemed the existing policy settings governing the system as given, but flagged that **stage 3 would assess the extent to which those policy settings inhibit the competitiveness and efficiency of the system.** The Commission now invites participant comment on this issue.

Policy impediments: GENERAL QUESTION FOR PARTICIPANTS

What are the material policy or regulatory impediments to the competitiveness and efficiency of the superannuation system? Please relate your comments to the relevant assessment criteria (in the Commission's assessment framework) and provide evidence of how and to what extent those policy impediments affect performance as measured by the related indicators.

The relevant assessment criteria for the matters covered by this submission is criterion E6. Page 8 of the Issues paper states:

System-level objective #2: The superannuation system meets member needs, in relation to information, products and risk management, over the member's lifetime

Assessment criteria

E6 Is the system providing high-quality information and intrafund financial advice to help members make decisions?

For the reasons explained in this submission our answer to E6 is "No".

Our previous submission

On 8 November 2016, the Actuaries Institute Superannuation Practice Committee forwarded a submission entitled "Product Dashboards and Disclosure" to The Treasury. A copy of that submission was sent to the relevant regulators, to the Productivity Commission and to the following stakeholders:

- Association of Superannuation Funds of Australia
- Australian Institute of Superannuation Trustees
- Consumers Federation of Australia
- Financial Services Council, and
- Industry Super Australia

Our proposals

An extract from page one of our previous submission is set out below. We have now added a further section on the right-hand side of the table as evidence of the way in which current (and proposed) government policy and regulatory requirements are acting as impediments to the competitiveness and efficiency of the superannuation system. The new section states our concerns and explains the key reasons why each change is recommended.

Our previous submission commences:

As you are aware, the Actuaries Institute is very interested in effective consumer disclosure. We have been concerned for some time about the effectiveness of the current superannuation disclosure regime and have prepared many submissions that set out our concerns.

The Institute believes that it is important that superannuation fund members become aware of the deficiencies in the current MySuper Product Dashboards (and the planned Choice Product Dashboards). We have therefore issued the Media Release in Attachment 1 which summarises our concerns. The key changes referred to in the media release are:

Changes	Key reasons
1. Net Investment Return to replace APRA'S Net Return reported on the dashboard.	Because of dollar-based administration fees, net returns are misleading for the vast majority of members who are not "representative". See page 6 and Attachment 3 of the above submission.
2. Return Target as defined by APRA to be replaced by the Trustee's SIS Investment Return Objective.	Superannuation fund members will be confused by the many subtle differences between Return Targets and SIS Investment Return Objectives. These create complex inconsistencies between dashboards and PDS's. Investment Objectives may be completely different to the Return Targets disclosed on dashboards (particularly for Choice products). To aid comparability, we have recently recommended to The Treasury, that Trustees should indicate the level of expected probability of achieving their Investment Objectives with a minimum or statutory level somewhere in the range of 60% to 70%.
3. A long term risk measure introduced and all risk labels removed.	Need to shift the current focus on the dashboards away from solely short-term investment risks to include a longer-term investment risk measure which is far more important to most members.
4. A breakdown table of fees and costs for three example members with account balances of $10,000, $50,000 and $250,000 respectively.	Such a table would provide fees and cost examples which better disclose differing dollar and 'asset-based' impacts for different account balances. Disclosures based only on 'total fees' can encourage market distortions. Consumers need the breakdown into investment and administration/advice components – see pages 2 to 6 of the above submission - in particular the two boxed sections on page 6.

5. Indirect costs to be split between investment and administration/advice and then aggregated with investment fees and administration/advice fees respectively (with the terminology "other costs" to replace "Indirect Cost Ratios" and "ICR's").	See pages 2 and 3 of Attachment 2 to the above submission. The separation of investment and administration/advice fees and costs is far more important than the separation of fees from indirect costs - many consumers will be unnecessarily confused if the superannuation industry retains the past focus on operational/mechanical differences between fees and costs. The main problem with the past strong distinction between fees and indirect costs, is that different funds treat fees and costs quite differently and the separation implies a false level of accuracy - very similar costs (and even very similar deduction of those costs from members' accounts) are variously treated as fees and/or costs by different funds. The key difference between a fee and cost is that the fee is known in advance whereas a cost is usually known after the period and is based on cost recovery – these subtleties are of little or no interest to members and should usually not enter comparisons between funds, products or services. The statement of fees and other costs must be kept as simple as possible - unnecessary and confusing jargon (such as "indirect costs", "indirect cost ratios" and "ICR costs") should be removed.
6. Remove the 'return target' line from the chart and add a table with a more direct and easily understood measure of investment performance against objective."	The MySuper dashboard chart has failed ASIC consumer-testing. It is so complex that even superannuation experts have difficulty understanding it. The Institute has suggested the complex chart be replaced with a colour-coded table (which compares returns against objectives) and a simplified chart with 2 not 3 components. An example is at page 4 of Attachment 2 to the above submission.

For the above reasons, we believe the current MySuper Dashboards do not achieve the government's objectives:

> *"… to provide key information about MySuper products, which is useful for both new and existing members, and for this information to be presented in a standardised manner to allow consumers to easily compare products and make informed choices"*

We do accept that an appropriate analysis of Dashboard metrics (with the changes that we have suggested, together with some insurance information) might be able to be used as a filter that will allow consumers to select a short list of products or investment options that might suit their requirements. It is also important to note that once the short list has been selected, the consumer would still need to refer to other material (e.g. the Product Disclosure Statements) or get advice to make an informed decision.

The Commission's Terms of Reference

The Commission's terms of reference state under the heading "fees, costs and net returns":

> "… the Commission should have particular regard to:
>
> - whether disclosure practices are resulting in a consistent and comparable basis for meaningful comparisons to be made between products"

It should be clear from our previous submission and the table above that current disclosure practices are not "resulting in a consistent and comparable basis for meaningful comparisons to be made between products".

The Commission's terms of reference also state under the heading "fees, costs and net returns":

> "… the Commission should have particular regard to:
>
> - whether additional disclosure would improve outcomes for members"

Whilst we are recommending some additional disclosures, one of our aims is to remove unnecessary and inconsistent duplications and to replace technically unsound dashboard components with information that will enable consumers to make better informed decisions about their choices of superannuation fund and investment options that affect their retirement savings.