Submission in response to key 2018 Federal Budget superannuation proposals

May 2018

1. Submission participants

This submission is made by:

- QIEC Super – a profit for members industry fund, established specifically for the benefit of all participants in the non-Government education sector, child and other care and community services in Queensland;
- Club Super - a profit for members industry fund, established specifically for the benefit of employees in the sporting and recreational clubs and associated industries in Queensland;
- Independent Fund Administrators & Advisers Pty Ltd (IFAA), a Brisbane based administrator of industry superannuation funds and managed investment schemes.

2. Executive summary

In the 2018 Federal Budget, the Government proposed a number of changes to the superannuation system, including.

1. making insurance opt-in for members who:
    - have low balances of less than $6,000, or
    - are under the age of 25 years, or
    - whose accounts have not received a contribution in 13 months and are inactive;
2. capping passive fees (administration fees and investment fees) for accounts less than $6,000 at 3% annually;
3. banning exit fees for all super accounts;
4. requiring the transfer of all inactive superannuation accounts under $6,000 to the ATO (with inactive being defined as having received no contributions or rollovers for 13 months);
5. introducing a retirement covenant requiring trustees to offer comprehensive income products for retirement and to provide simplified, standardised metrics in disclosure documents;
6. a one-year exemption from the work test for voluntary super contributions for people aged 65-74 with superannuation balances below $300,000.

While it is recognised that the budget also contained other superannuation proposals, this submission focusses on the above aspects, which we consider to be most problematical.

While the above proposals may seem to have merit at a prima facie level, in minimising deductions from member accounts and facilitating account consolidation, there are a range of potentially very significant adverse consequences at both member level, and system level, that do not appear to have been fully considered. Our specific concerns are spelt out in section 3.

However, at a higher level:

- some of the proposals amount to the Government removing the ability of individuals in the target groups to make informed decisions in their own interests, which in many cases includes keeping small accounts to maintain invaluable bespoke insurance. Instead, the Government assumes it knows better than the individuals what is in their best interests.

  As outlined below, we forsee this to be to the significant disadvantage of many people who will lose their insurance, and the security which it brings.

- The transfer of inactive accounts to the ATO has the very real potential to adversely impact the stability of the superannuation system. As outlined below, given the high number of small balance accounts across the industry, significant losses of members, assets and revenue by superannuation funds is very likely to bring the viability of some superannuation funds into serious question. It is not unrealistic to forsee that some superannuation funds may have no option but to wind-up or merge, if these proposals are implemented. This raises the prospect of serious systemic risk in the context of transferring accounts of potentially hundreds of thousands of members, winding up of funds etc. The process of some funds winding up also risks affected members further disengaging from superannuation, as they may well lose faith in the system, with such people likely to consider alternative investment vehicles. **It would be exceptionally disappointing if the Government was using these proposals as a tool to expedite consolidation of the industry.**
- As above, the inactive account transfer proposal will significantly reduce the size of many funds in the industry, both in terms of assets and members, thus having a major adverse impact on the scale position of many funds. APRA has been requiring the industry to conduct an annual MySuper scale test since 2013. The larger funds in the industry already have adequate scale, but many small and medium sized funds have designed and implemented a broad range of strategies in recent years to increase the scale of their fund, and to improve their member offering, at cost to current members. **It is incongruous for the Government and APRA to hold superannuation funds to scale requirements, while introducing initiatives that directly and significantly detract from the ability to attain scale and improved efficiency outcomes for members.**
- We expect there to be many people, and their families, who will experience financial devastation upon suffering disablement or death, after having lost insurance coverage, as a result of having their inactive account transferred to the ATO. This will cause such individuals to have to deal with personal grief, combined with financial hardship. This is expected to have the greatest impact on low income workers not in full time employment, and those people taking a break from the workforce. As women predominantly make up this group while taking a break to raise children, women are expected to be hardest hit by this measure. **For Government policy to leave women and other inactive account holders and their families without the security of insurance is unconscionable.**
- There may be merit in the Government introducing a retirement covenant, thus requiring Trustees to develop strategies for the investment of post retirement assets and the offering of appropriate post retirement products. However, the structure of 'Comprehensive Income Products for Retirement' (CIPR) will inevitably be complex, and such products are likely to be costly. Many members may not be attracted to a product with complexity and high cost, and therefore the take-up of CIPR's may be low, which would leave the broader membership bearing higher fees and costs for a product that few of them are actually members of, or even interested in. **The offering of CIPR's should not be compulsory by superannuation funds.**

Based on the significant concerns we have raised throughout this submission, we request that the Government fundamentally reconsider the superannuation proposals in the 2018 budget.

3. Key superannuation proposals in the 2018 budget

A) Insurance opt-in

Existing members required to opt-in

Under the proposals, it is not only new members that will be subject to the insurance opt-in rules. Members with existing insurance coverage that fall within the nominated target groups, will also have to opt-in. Apart from the very unusual situation of requiring these people to opt-in to benefits they already have, it is inevitable that some (if not many) of these members will not opt-in, and will lose the security of insurance which they previously had. Despite the best efforts of superannuation funds and the rollout of communication strategies, some of these members may not become aware or understand this very important change. **It is inevitable that some people in this situation will find themselves in the catastrophic situation of suffering disability or death, and thinking they have insurance coverage when they do not, which will have devastating consequences for themselves and their families.**

Similarly, given the relatively low levels of member engagement across the industry, it is expected that many, if not most, new members will also not opt-in and will be exposed to financial devastation in the event they suffer disablement or death and are not covered by insurance.

In addition to the expected significant impacts at a personal level, the outcomes flagged above also foreshadow impacts at a societal level. People (and their families) who do suffer disablement or death, without the protection of insurance, will likely bear resentment at being plunged into financial crisis, while also suffering personal grieving. Given the desperate circumstances some people will be confronted with, this has the potential to manifest in higher crime, and increased rates of mental health episodes, with consequent impact on other members of the community, and Government support programs.

Higher premiums for remaining insured members

If implemented, the insurance opt-in proposals will very significantly reduce the pool of insured members for all funds, and will also significantly reduce premiums collected. In accordance with the principles of insurance pricing, given there will be a smaller pool of insured members which represent a higher risk, it is expected insurers will increase premiums, which will be borne by remaining insured members.

The increased risk will eventuate when it is considered that those who opt-in to insurance are at risk of 'selecting' against the fund, and will be much more likely to lodge a claim.

The above expected premium impacts also have the potential to create a vicious cycle, in that higher premiums may well cause a portion of remaining insured members to cancel their cover, further reducing the pool of insured members, with the potential for further premium increases, and further member cancellations. This has the potential to threaten the viability of some insurance pools.

Bearing increased premiums is an unreasonable outcome for those members who retain insurance within the funds, and is not in their best interests.

B) Capping administration and investment fees

The proposal to cap passive fees, including administration and investment fees for accounts less than $6,000, at 3% annually, raises a number of issues. This essentially re-introduces the concept of 'member benefit protection' (MBP) in a new guise, with MBP having been abolished only 5 years ago, upon the recommendation of the Cooper review.

The administration of this proposal is likely to be costly and complex to administer. It may require calculation and application of a rebate at year-end for all members with account balances under the $6.000 threshold. This will require development of system changes to administer these rules, which will come at extra cost to existing members.

It should be recognised that the additional costs which would not be borne by these low account balance members under this proposal, still exist. As a result, superannuation funds may need to increase administration or other fees to recoup these costs. This will mean remaining members would be cross subsidising the low account balance members. **This runs counter to the principles of the MySuper regime, which specifically prohibits cross subsidisation across membership categories.**

C) Abolishing exit fees

This proposal appears to be aimed at facilitating transfers between accounts, and removing any fee impacts on members who wish to rollover or consolidate their accounts. At face value, this appears to have merit, by removing a barrier to consolidation. However, the proposal is likely to have adverse consequences.

Under the current MySuper rules, exit fees are classified as activity fees, with members paying this fee based on the benefit payments they receive (with the fee reflecting the cost associated with processing benefit payment transactions).

Abolishing exit fees does not remove the costs associated with processing these transactions. Therefore, superannuation funds will have to consider recouping these costs via other fees, which might involve administration fees increasing, for all members. In this scenario, those members who are not active in requesting benefit payments will be partially subsidising those members who do request benefit payments. **This outcome would be completely at odds with the principles of the current system, which reflects a user pays arrangement for activity based requests, such as benefit payments.**

D) Transfer of inactive accounts to the ATO

We have a number of significant concerns about this proposal, as outlined below. We consider there will be more losers than winners arising out of this initiative, and we predict there will inevitably be some catastrophic human impacts.

Higher fee and cost impact on remaining members

This proposal has the potential to significantly reduce the membership base of superannuation funds. For QIEC Super and Club Super, it has been estimated that based on proposed parameters, this proposal could result in up to 25% of fund members being transferred to the ATO from 1 July 2019. Additional significant leakage is forecast to occur on an ongoing basis. It is expected that many superannuation funds in the industry will experience similar, and possibly greater impacts.

While it may be considered that superannuation funds will have less costs in administering fewer accounts, there exists certain fixed costs which will not reduce. Consequently, these fixed costs will be borne by a smaller group of members, meaning funds will likely have to increase administration fees. **Bearing increased administration fees is an unreasonable outcome for those members who remain in the funds, and is not in their best interests.**

Impact on women and other inactive account holders

Many working parents and especially young working mothers will lose their insurance cover when they take time off work to care for young children and their accounts become inactive. In this scenario, such individuals will have their account transferred to the ATO, thus losing the insurance cover they had in their superannuation account. For many, this insurance is the only protection and security they and their dependent families have against disablement and death.

Given many more women than men take a break from the workforce to raise children, this proposal will predominantly disadvantage women, and will result in significantly worse financial outcomes for those women that suffer a disability, or for their families in the event of their death. At this time of their lives, with little or no income, insurance is the only security they have, to protect against disablement or death. This proposal will reduce the financial security for a discrete and already financially disadvantaged group within society. **For Government policy to leave many women, other inactive account holders and their families without the security of insurance is unconscionable, and reverses modest gains in recent years in reducing the disadvantage experienced by many women.**

While the Government has announced the intention to eventually consolidate such funds into the other superannuation accounts of members, such people may not qualify for automatic insurance in the new fund, because under these proposals, they may fall into one of the categories requiring insurance opt-in. Given the low level of engagement and understanding of superannuation by the general public, we believe many members in this situation, if not most, will not opt-in, and will be left without vital insurance coverage. Also, for the period that the Government holds these funds prior to transferring it to the other accounts of these members (which we understand could be up to 12 months), the members will certainly have no insurance and will be left seriously exposed. In addition, for the period that the Government holds the funds, members will be losing out in terms of foregone investment earnings.

Human impacts

If this proposal is implemented, it is inevitable that there will be numerous heartbreaking scenarios, where families suffer the death or disablement of a partner or parent, and are left without insurance coverage (which they previously had). This will be devastating for the surviving family members, as not only will they have to deal with the death or disablement of a loved one, but they may also face serious hardship for the rest of their lives. Outlined below are some individual case studies of actual members in our superannuation funds who have been disabled or died, and they or their beneficiaries have been provided with life changing insurance payouts. These examples demonstrate real life scenarios whereby insurance cover has demonstrably made a very real and positive impact on members who have suffered disability or death.

If the Government's proposals had been in place at the time these individuals were disabled or died, they may not have had this insurance cover, or in some cases definitely would not have had this insurance cover, in which case the outcome for these members or their beneficiaries would have been infinitely worse.

Examples

1) A female member was aged 19 at the time of her total disablement, and had an account balance of under $6,000. The member suffered a severe traumatic brain injury and spinal injury after being involved in a car accident. The member received default Death, Total and Permanent Disablement (TPD) and Income Protection (IP) cover on joining the Fund in the previous year. She has been

paid out a TPD benefit of $181,500 and will also receive ongoing Income Protection benefits for up to 5 years (approx. $2,000 p/month ~ $120,000 in total). These benefits will greatly assist the member in receiving the high level medical care she will need for the rest of her life.

If the budget proposals had been in place, this member would only have had this insurance cover in place had she opted-in to insurance. Given the level of disengagement of young people with superannuation, we consider it unlikely that the member would have opted in at age 19, and so would likely not have received this insurance payout, with the consequences plain to see.

2) A female member was aged 36 at the time of her sudden death, and had an account balance under $6,000, and her account had been inactive for 2 years. The member received default Death, TPD and IP cover on joining the Fund. The insured benefit of $181,500 was paid to her spouse, which will greatly assist with raising their 6 year old daughter.

   If the budget proposals had been in place, this member would have had her account transferred to the ATO, with the associated loss of her insurance coverage. In that scenario, the member's surviving spouse and daughter would have faced a far more uncertain financial future, in addition to the personal grief of losing their partner and mother.

3) A female member was aged 24 and had an account balance under $6,000, and her account had been inactive for approximately 12 months. The member was the victim of a hold-up at her place of employment, and was diagnosed with post traumatic stress disorder. The member received default Death, TPD and IP cover on joining the Fund. The member was paid out a TPD benefit of $300,000, which will provide greatly needed financial security, given her limited employment prospects.

   If the budget proposals had been in place, this member would have had her account transferred to the ATO had her account got to 13 months of inactivity (which looked likely based on her account history), with the associated loss of her insurance coverage. In that scenario, the member would have faced a very uncertain employment future, without the financial security that the insurance payout provided. This would have undoubtedly added to her existing psychological trauma.

Impact on the welfare system

Removing insurance protection for hundreds of thousands, if not millions of members across the superannuation industry, is expected to have major cost consequences on the Government welfare system. For those members that experience disability or death, without the security that an insurance payout provides, they or their families will look to Government for financial support. Given the number of members likely to be impacted, the cost to Government could be very significant. This may impact not just ongoing Government income support, but also greatly increased claims on the National Disability Insurance Scheme. **The Government needs to give greater consideration to the expected significant welfare impact of this proposal, as a result of large numbers of people losing existing insurance coverage.**

Government override of personal strategies

Some members keep small balances in superannuation accounts (which may or may not be inactive), to maintain vital insurance cover that they cannot obtain elsewhere. For example, different policies have different disablement definitions and/or pre-existing illness and injury exclusions, whereas the individual may be a long serving member of a particular fund, and has access to much more favourable insurance under old rules. Forcing these small / inactive accounts to close and transfer to the ATO will result in a catastrophic loss of vital insurance cover for these individuals. Under the proposals, such people will apparently not be given the choice to advise they wish to maintain these small / inactive accounts, and will automatically have their account transferred to the ATO, upon which their bespoke insurance coverage will be lost. **It is unacceptable for Government policy to override the legitimate strategies that certain people may have in place to preserve favourable and vital insurance cover.**

Impact on young people

For young people today, maintaining a stable job with one employer is a very real difficulty and changing jobs and/or taking a leave of absence to further train and/or travel overseas is a reality for many. Closing their inactive superannuation accounts will force them to not only lose their (in many cases) sole insurance protection, it makes it very hard for these young people to grow their small retirement savings over time.

For those people who don't have other superannuation funds into which to consolidate, their assets will remain with the Government, invested in cash based investments delivering nominal returns. This is contrasted with the potentially much more positive returns available if their funds had remained invested in their superannuation fund in a growth or balanced portfolio over the long term. **This could make the difference between a comfortable retirement and an undignified one.** Consequently, this has the potential to then impact the fiscal position of Government, as increased numbers of people are likely to rely on the age pension in the absence of having their own superannuation account with an adequate balance to fund their retirement.

Discouragement to invest in superannuation

The level of member engagement in superannuation is already low across the industry. There are a number of reasons for this, including:

- the rules are too complex for many members to understand;
- the rules are constantly changing due to Government tinkering, making comprehension of superannuation even harder;
- the fact members can't access superannuation until retirement age (with limited exceptions), so personal interest levels are low for many members.

Many people will likely conclude that the security which they thought they had in their superannuation account via insurance coverage, has suddenly disappeared as a direct result of Government policy changes. Such people may well look for alternative vehicles which provide greater certainty, and less volatility in the regulatory landscape. Additionally, many members are likely to be dissatisfied about the perception of losing their superannuation account to the ATO, and may question the worth of superannuation as a result. **Consequently, these proposals may well serve as a discouragement for people to use superannuation as their primary retirement savings vehicle.**

E) Introducing a retirement covenant

It has been proposed to introduce a retirement covenant, requiring Trustees to have in place strategies for the investment of post retirement assets and the offering of appropriate post retirement products. This includes the proposal to make the offering of a 'Comprehensive Income Product for Retirement' (CIPR) compulsory by superannuation funds.

The Government introduced the concept of CIPR's a couple of years ago, with the aim of encouraging the development of post retirement products that offered the flexibility available in existing account based pensions, combined with the security offered by life insurance type products in terms of longevity risk.

By their nature, CIPR's have significant complexity attached to them, and are likely to require co-ordination between superannuation funds and life insurers in the creation of such products. This is due to the fact that many, if not most, superannuation funds are not able to insure against longevity risk themselves.

Due to these factors, the cost associated with development of these products and the uncertain regulatory environment in which CIPR's would operate, there has been very little progress in the Australian superannuation market in developing such products.

It may also be the case that CIPR's are not the most appropriate post retirement product for a superannuation fund to offer, based on the demographics of their membership. For example, many members may baulk at the complexity of CIPR's and the expected higher cost. It is noted that it is not proposed that it be compulsory for members to take up a CIPR. Therefore, superannuation funds may be left in the scenario where they have incurred considerable time and cost in the development and introduction of a CIPR, only for there to be a very low uptake. This would leave the members bearing higher fees and costs for a product that few of them are actually members of, or even interested in. **We consider that while the introduction of a retirement covenant may have some merit, the offering of CIPR's should not be compulsory by superannuation funds.**

F) One year work test exemption

The proposal to introduce a work test exemption for those aged 65-74, with superannuation balances below $300,000 for one year after they last meet the test, seems arbitrary. While the proposal has the potential to allow members in this group to accumulate additional funds for their retirement, the administration of the initiative will be difficult. It will require superannuation funds to adopt manual processes to track the one year period after they last met the work test.

It is unclear whether the ATO alone will monitor whether individuals have exceeded the maximum $300,000 superannuation balance across all funds, requiring return of contributions for those members who fall outside of these parameters, or whether superannuation funds will need to integrate with ATO systems to determine if the member has less than the maximum balance. **Implementation of this proposal is likely to be manually intensive and potentially expensive for superannuation funds to administer.**