

29 May 2018

Manager, Regulatory Framework Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam

Subject: Submission – Protecting your super package

We are pleased to provide this submission in response to the government’s “Protecting your super” package released as part of the 2018 Budget announcements.

Willis Towers Watson is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has over 40,000 employees serving more than 140 countries. We design and deliver solutions that manage risk, optimise benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. In Australia, we provide actuarial, communication, technology and superannuation and investment consulting services to a broad range of defined benefit and accumulation superannuation funds including standalone corporate funds, industry funds, master trusts and master trust sub-funds, and a wholly owned subsidiary of ours acts as trustee to a number of corporate funds.

Our Submission

We recognise the importance of ensuring that Australians’ superannuation benefits are not inappropriately reduced by fees and insurance premiums. However, we do have some concerns with some aspects of the draft legislation released for consultation. These concerns are discussed in the following sections of this letter. In this letter, all legislative references are to the Superannuation Industry (Supervision) Act 1993 (Cth) (“SIS Act”) unless otherwise stated.

Brad Jeffrey
Director, Superannuation Services, Australia

Level 16, Angel Place
123 Pitt Street
Sydney
NSW 2000
Australia

T +61 2 9285 4000
D +61 2 9253 3110
M +61 419 944 149
E Brad.Jeffrey@willistowerswatson.com
W willistowerswatson.com

Towers Watson Australia Pty Ltd
ABN 45 002 415 349 AFSL 229921

DO: RMB | TR/CR/ER:PP

Employer-provided insurance cover

Under the proposed changes, superannuation funds will only be able to offer insurance cover on an opt-in, rather than opt-out, basis in the following circumstances:

- where the member's account balance is less than \$6,000 or
- where the member is aged less than 25 years or
- where the member's account has been inactive for a continuous period of 13 months.

While carve-outs have effectively been provided in relation to defined benefit members under proposed sections 68AAB(3), 68AAC(3) and 68AAA(5) respectively, there does not seem to be a carve-out in respect of accumulation members for whom the employer provides standard insurance cover as an employee benefit in addition to Superannuation Guarantee contributions at no cost to the employee. We are aware of a number of corporate funds and master trust sub-funds where this situation applies.

It appears to us that if the draft legislation is not amended, trustees of such funds will be required to seek opt-in from these members, even though their arrangements fully comply with the government's objective to avoid inappropriate erosion of balances, as discussed above. While there is no logical reason why such members would not opt in to cover which is provided free of charge, there are likely to be members who will fail to do so, whether because of illness, leave, change of address, oversight or sheer inertia. In addition, the cost of following up members, and the possibility of changes to cover discussed below, would seem to impose unnecessary burdens in these cases.

We therefore strongly recommend the government provides a carve-out from the opt-in requirement for all employee members whose employer provides standard insurance cover in addition to Superannuation Guarantee contributions at no cost to the employee. Limiting the opt-in requirement to Automatic Insurance Members, as defined by the Insurance in Superannuation Voluntary Code of Practice ("Code") may assist in achieving the recommended carve-out.

Inactive account definition

Paragraph 68AAA(3) of the draft bill proposes to define an account of a member as being inactive in relation to a choice product or MySuper product for a period if the trustee has not received an amount in respect of the member that relates to that product during that period. Where a defined benefit fund has a surplus, it is possible for the employer to take a contribution holiday in respect of both defined benefit and accumulation members. In this situation an amount equal to the regular employer contributions would be allocated to the accumulation members from the surplus rather than being paid into the fund. The use of the word "received" in the definition means that accumulation members could incorrectly be classified as inactive during such a period, as contributions would be allocated to them by the trustee but would not be received from the employer.

We recommend draft paragraph 68AAA(3) be amended to correct this anomaly.

Consequences of opt-in

When an individual purchases a personal life insurance policy, cover is normally only granted if the individual provides evidence of good health that is satisfactory to the insurer. For higher levels of cover, evidence of financial need may also be required. These requirements are referred to as "underwriting" and are intended to reduce selection risk, which is the risk that an individual takes out cover with the intention of claiming on the policy shortly after cover commencement (by which time only a very small premium would have been paid compared to the sum insured).

Currently insurers do not require underwriting for the vast majority of new members to a group insurance policy, provided certain conditions, designed to minimise selection risk, are met. This is called “automatic acceptance”, and the conditions vary between group insurers but commonly require a certain percentage (typically 75%) of new members to commence cover when first eligible. These conditions enable the insurer to provide cover to those who would likely not be covered under an individual policy – for example, because they are in poor health, or are employed in an occupation which would otherwise be an unacceptable risk. Opt-out cover meets the conditions for automatic acceptance. However, cover that is in effect opt-in for the majority of new members to a super fund is most unlikely to meet insurers’ conditions for automatic acceptance.

There are a small number of superannuation funds that currently provide opt-in cover for members below certain ages, typically 20 or 25. Insurers impose conditions on cover under these opt-in arrangements that do not apply to standard cover in funds that are opt-out. These conditions include:

- exclusions for a period of time, typically 13 months, for claims arising from suicide, self-inflicted injury or attempted self-harm, regardless of whether the person was sane at the time
- the provision of ‘limited’ cover only for a period of time, typically two years. Under limited cover, no cover is provided for claims arising from an illness or injury that was apparent to the person before their cover started.

These conditions are imposed to manage the risk that the individuals who opt in to cover are more likely to be those in poorer health (and hence more likely to become claims). We expect that conditions such as these, as a minimum, will need to be imposed by insurers on all superannuation funds as members move from opt-in to opt-out as a result of the government’s proposals. The only other way that insurers could manage the increased risk is via increases in premiums for all members, further impacting their retirement savings. Indeed, we expect premiums will increase for all members irrespective of whether such underwriting conditions are imposed by insurers, as discussed further below.

There are likely to be other adverse consequences from changing from opt-out to opt-in. Insurers typically provide lower premiums (all else being equal) where the number of members insured in a fund is greater. We are aware of a number of funds with high proportions of young and/or low account balance members whose trustees are expecting their total number of insured members to fall significantly as a result of this change – in one case, the number of insured members may halve. Such a reduction would trigger the insurer’s right under the policy to review the pricing, and we expect that premium increases for all members will result.

Automatic acceptance is a very powerful feature that helps provide cover for the broadest range of Australians, not just the most healthy, and is a large contributor to the efficiency of delivery of group insurance which means that group insurance costs can be only 50% of the comparable retail insurance costs. The opt-in requirement will at the very least dilute the power of automatic acceptance and can only increase the costs for all remaining insured members.

The increase in complexity associated with cover being opt-in for some members will also increase the risk of errors occurring, such as in relation to members’ records being updated correctly and in a timely manner, cover switching on and off at the correct times, or insurance conditions being correctly applied. We expect this will result in increases in the cost of administration, which will ultimately be borne by all members. It will also increase the risk of members not being covered when needed due to circumstances outside their control – for example, because a late paid employer contribution results in them being opt-in rather than opt-out at the date of death or disability.

In view of these observations, we recommend that further consideration be given to the consequences of the proposed opt-in criteria.

Opt-in requirement for active contributing members

While we can see the logic that members under age 25 and inactive members are more vulnerable to account balance erosion, the logic for opt-in for contributing members aged over 25 is weaker.

In practice it will usually take some months or years for a new member's account balance to reach the \$6,000 threshold for the first time solely by way of employer contributions. The effect of these rules in practice, therefore, is that virtually every new member to a superannuation fund will be required to opt-in to insurance cover unless they open their membership of the fund by way of a roll-in or voluntary contribution greater than \$6,000.

When a new member commences default contributions in a new fund, the combination of cover cessation in the old fund (which may be well before 13 months has expired) and opt-in requirements in the new fund (due to their balance being less than \$6,000) will result in gaps in insurance coverage for the disengaged member. A full-time worker on average earnings is likely to take longer than 13 months to reach a \$6,000 balance, meaning that their old cover will cease before their new cover commences in the new fund. This gap in cover will be exacerbated for part-time or lower income workers, who are perhaps more likely to be disengaged with their superannuation. This is particularly the case if there are delays in employer remittance of SG contributions that may cause a member to become uninsured due to circumstances outside their control.

Superannuation funds are taking major steps to review their default insurance designs to tailor coverage to their specific membership and provide cover in compliance with the 1% affordability requirement of the Code and other requirements. We consider that for active contributing members, these insurance designs should be able to be provided on the current opt-out basis.

We therefore strongly recommend that the opt-in requirement for employer sponsored members with balances under \$6,000 be removed.

Communication requirements for opt-in

The draft legislation and summary of proposed regulations both contemplate additional communication and disclosure obligations in relation to the opt-in arrangements, both in the lead up to the new regime and thereafter. It will be essential for trustees to be able to communicate with members in the most efficient way possible in order to minimise the increase in costs that will be associated with these changes.

To address uncertainty around the Corporations Act requirements in relation to electronic disclosure, ASIC has issued a relief instrument – *ASIC Corporations (Facilitating Electronic Delivery of Financial Services Disclosure) Instrument 2015/647* – and Regulatory Guide *RG 221 Facilitating digital financial services disclosures* which, among other things, enable trustees to meet certain disclosure obligations to a default member by using an email address provided by the member's employer. For choice members, funds increasingly collect email addresses at the time of joining. However, this left a gap in respect of choice members who joined the fund prior to 2015 when the relief instrument was made.

Despite multiple campaigns to obtain email addresses and consents from these members, there are many reasons why such campaigns do not always result in significant response rates in addition to a conscious refusal by a member to respond, such as incorrect address details, illness, absence from their normal residential address, oversight and inertia. The volume of material with which members will need to be provided will likely serve only to add to the inertia. We would therefore encourage the government to work with ASIC to permit trustees to use pre-existing choice members' employer email addresses on the same opt-out basis as default members for these member communications, should they consider it in the best interests of members to do so.

Implementation time frame for opt-in

It is currently proposed that opt-in will commence from 1 July 2019, with the communications requirements for inactive accounts commencing 1 May 2019. This leaves less than 12 months for almost every APRA regulated fund in Australia to renegotiate the terms of its group insurance policy, revise its disclosure documents, website, call centre scripts and letter templates, make the required administration system and process changes and train its staff.

We do not consider this to be a reasonable time frame, as the renegotiation of insurance policy terms can only commence once the legislation is passed by Parliament in its final form and, as noted above there is a significant amount of consequent work to be undertaken. We therefore recommend that any opt-in requirement not commence until at least 18 months after the passing of the enabling legislation.

Cap on administration and investment fees – indirect costs

Proposed section 99G in the draft bill intends to cap the total combined amount of administration and investment fees charged to certain low-balance accounts. However, the draft bill does not refer to indirect costs by which some funds recover some or all of their investment related costs from fund members. Indirect costs are not a defined term in the SIS Act. Rather, they are defined in Schedule 10 to the Corporations Regulations. Importantly, under paragraph RG 97.27 of ASIC Regulatory Guide *RG 97 Disclosing fees and costs in PDSs and periodic statements* (current version dated March 2017), costs that are not payable out of the fund and that would otherwise be part of investment fees or administration fees (such as costs paid by the operator of an interposed vehicle in which the fund invests) may be instead treated as indirect costs if the trustee has elected in writing to treat those costs as indirect costs.

In the absence of a reference to indirect costs in the proposed cap on administration and investment fees, it would be open to trustees to take advantage of the option provided by RG 97.27 and elect to treat certain amounts as indirect costs rather than fees in order to leave more “space” in their administration and investment fees before the cap cuts in.

We recommend the government considers whether this was the intention of the proposed cap. At a minimum, we recommend the government works with ASIC to ensure that the guidance in RG 97 and any related legislative instruments are updated to accurately reflect the government’s intentions in this regard.

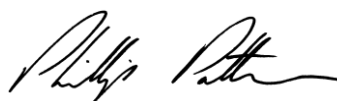
■ ■ ■

We appreciate the opportunity to contribute to the development of this important policy issue. We would be pleased to discuss this letter with you or provide any further information needed.

Yours sincerely



Brad Jeffrey
Director, Superannuation Services, Australia



Phil Patterson
Head of Insurance Solutions