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Retirement Income Review

Dear Sir/Madam

Re: Berrill and Watson Lawyers Submission to the Retirement Income Review

We are grateful for the opportunity to make this brief submission in relation to one aspect of the Retirement Income Review that is specifically relevant to our expertise and experience.

About Us

Berrill and Watson Lawyers is a national law firm practising exclusively in superannuation and insurance and Centrelink for consumers. We represent superannuation fund members, insureds, people with disabilities and consumers.

The author of this submission has worked in superannuation and insurance for 28 years and has been on the boards of the Superannuation Complaints Tribunal Advisory Council, the Financial Ombudsman Service (now the Australian Financial Complaints Authority) and the Consumer Action Law Centre. He has also made numerous submissions to government inquiries, including to the 2019 Productivity Commission report on "Superannuation: Assessing Efficiency and Competitiveness".

We have limited this submission to the principle of equity raised in the Consultation Paper and specifically whether the retirement incomes system, and in particular the compulsory superannuation pillar, delivers equitable outcomes for people who experience disability.

Compulsory Employment Superannuation

The premise of compulsory employment superannuation is that workers would compulsorily acquire superannuation over the course of their working lives sufficient to provide an adequate retirement income.

The Superannuation Guarantee is tied to a percentage of a worker's Ordinary Time Earnings (OTE) which does not include non-personal exertion income.

The legislated rate increased from 3% to 9% of OTE between 1993 and 2002 and flatlined thereafter, save for one 50 basis points increase in 2014. It is currently legislated to increase progressively to 12% by 2026.

There was also an age limit for Superannuation Guarantee contributions of 70 but this was abolished in 2013.

There has been much debate about the adequacy of the Superannuation Guarantee rates but there can be little doubt that if a person does not maintain a full working life, the Superannuation Guarantee will not provide an adequate retirement income.

This shortfall is perhaps most profound in someone whose working life is cut short because of disability. Disability, whether through injury or illness (or both) can occur at any stage in the working life cycle and can result in a reduction in and/or a total loss of income from personal exertion. This in turn results in a shortfall in compulsory superannuation. The longer the period of incapacity, the greater the compounding adverse effect on the disabled person's retirement income.[1]

Insurance in Superannuation

Historically, government pension schemes and employer-sponsored defined benefit funds included permanent incapacity or death lump sums or pensions, sometimes underwritten by life insurance contracts.

These benefits were designed to provide the equivalent of a full retirement benefit in the event of premature disability or death.

The 1980s heralded occupational superannuation with the emergence of not-for-profit industry funds and for-profit retail funds. These funds sought to replicate defined benefit funds by providing life, Total and Permanent Disability (TPD) and income protection insurance benefits provided under group insurance contracts funded by premiums deducted from occupational superannuation contributions.

Again, the insurance benefits were designed to supplement a member's accumulated superannuation account to provide something approaching an adequate retirement income in the event that his/her working life was cut short by disability (or to dependents in the event of premature death).

The trend was turbocharged with the introduction of compulsory superannuation under the Superannuation Guarantee (and Administration) Act 1992 with millions of Australian workers obtaining life insurance for the first time.

Regulatory enhancements followed with modest death insurance cover up to $50,000 mandated with the introduction of Choice of Fund legislation in 2005 and default death and TPD insurance cover and optional income protection insurance cover included as minimum standards for MySuper- compliant funds in 2014.

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[1] Overview: Productivity Commission Report into Superannuation: Assessing Efficiency and Competitiveness, pg 19.

The end result is that almost all Australian workers have life insurance through employment superannuation.

Commissioner Hayne in the final report of the Financial Services Royal Commission noted that insurance in superannuation had become a significant feature of the Australian superannuation system and was a means of spreading risk which brings significant benefits for both individuals and communities.[2]

This echoed the findings of the Productivity Commission which was that group insurance arrangements in superannuation delivered more affordable insurance than people would be able to obtain through individually written cover outside superannuation.[3]

However, the Productivity Commission report noted that there had been problems with group insurance and that not all members receive good value from insurance in their superannuation.[4]

Problems with Insurance in Superannuation

Insurance in superannuation has delivered billions of dollars of financial support to people whose working lives have been cut short by disability. It has also saved taxpayers billions of dollars in welfare payments that would otherwise have been payable.[5]

However, the insurance comes at a cost in the form of premiums which necessarily erode members' superannuation accounts. The issue that has rightfully be raised is the extent to which that insurance with those premiums represents value for money in the retirement incomes framework.

Some of the problems identified in recent years with group insurance in superannuation which have affected this assessment include:

1. Harsh or unfair definitions and contract terms;
2. Multiple superannuation accounts with duplicate income protection benefits;
3. Poor claims handling practices;
4. Prolonged claim timeframes.

Recently the Australian Securities and Investment Commission (ASIC) produced a report into TPD insurance[6], including group insurance in superannuation. The ASIC report found that there are some group insurance arrangements which have adopted Activities of Daily Living (ADL) definitions in respect of certain cohorts of members, such as casual workers and those in "high risk" occupations. ADL definitions are far more stringent, and the report found much higher decline rates than for standard "suitable occupation" TPD claims.[7]

The Productivity Commission's report highlighted the historical problem of duplicate accounts. Over one third of all superannuation accounts are duplicate accounts which means many are paying

[2] Royal Commission into Banking, Superannuation and Financial Services Industry Final Report Volume 1, pg 330.
[3] Productivity Commission Inquiry Report No. 91, 21 December 2018, pg 19.
[4] Ibid.
[5] See Rice Warner report Underinsurance in Australia 2016.
[6] ASIC Report 633: Holes in the safety net: A Review of TPD insurance claims (October 2019).
[7] Ibid, pg 36 [107-108].

administration and other fees associated with each of the accounts.[8] Some (although not all) of those accounts include continuing account-based insurance cover. Whilst life and TPD cover invariably is not offset against other such cover, the same cannot be said for income protection insurance. Accordingly, some members are paying for insurance that they cannot claim on.

The Hayne Royal Commission[9] considered some insurance claims case studies, including some involving group life insurance claims through superannuation. Commissioner Hayne found the case studies revealed concerns in relation to unfair practices in claims handling processes such as oppressive investigations and demands for information and documents.

Delays in being paid insurance benefits have long been a concern for consumers. That concern is more significant when the reason for an insurance claim is that an insured is no longer able to work and earn an income. Unsurprisingly, ASIC have raised concerns in relation to claim time frames in respect of TPD insurance, including in group insurance in superannuation.[10]

Each of the issues has impacted on the value of insurance in superannuation as a retirement income product. However, TPD, life and income protection insurance provided through superannuation have amongst the highest loss ratios of comparable insurance products which indicates that they are well targeted and still represent good value for money.

Recent developments

In the last few years there has been substantial attention from regulators and the Federal Government to consider and address some of these problems.

The Productivity Commission and the Hayne Royal Commission made a number of recommendations to improve product design and availability and claims handling, the Federal Parliament has passed laws to better target insurance in superannuation and prevent inappropriate account erosion, and the regulators, APRA and ASIC, have proactively monitored and reviewed fund and insurer compliance.

In addition, the life insurance and superannuation industries have implemented Codes of Practice which deal with product design, sales, claims and complaints. The life insurance Code of Practice commenced on 1 July 2017. The superannuation industry for its' part has introduced the Insurance in Superannuation Voluntary Code of Practice which has being adhered to by many funds since its announcement in 2018 and which is to be fully implemented by the end of 2020. Both Codes have come in for some criticisms and both are under their first reviews.

Of particular significance to insurance in superannuation, was the introduction of the Protecting Your Super (PYS), and Putting Members Interests First (PMIF) legislation, which both passed in 2019. As a result of these pieces of legislation the following significant changes occurred:

1. Inactive-low balance accounts are to be transferred to the Australian Taxation Office and then reunited with other active superannuation accounts;

2. Superannuation trustees are required to only provide insurance cover to members with inactive accounts on an opt-in basis.

[8] Productivity Commission Inquiry Report No. 91, 21 December 2018, pg 16.
[9] Royal Commission into Banking, Superannuation and Financial Services Industry Final Report Volume 2.
[10] ASIC Report 633: Holes in the safety net: A Review of TPD insurance claims (October 2019), pg 63-65.

3. Superannuation trustees are required to only offer insurance to people under 25 years of age on an opt-in basis unless they are employed in hazardous occupations;

4. Superannuation trustees must only provide insurance to members with low account balances (under $6,000) on an opt-in basis.

Some of the changes have already been implemented, whilst others come into effect in April 2020. All have necessitated the review and renegotiation of group insurance arrangements across the superannuation industry to ensure compliance with the new laws.

With the obligations imposed by the Regulators and the Code obligations, insurance in superannuation is in the midst of a major reset which it is hoped will improve the value for money of the products.

But perhaps the most significant piece of work is the consultation currently being conducted by Treasury into potential universal terms and conditions for insurance in superannuation.

The review was a specific recommendation of the Hayne Royal Commission[11] and may result in the adoption of standardised terms and conditions in MySuper-compliant default insurance in superannuation.

The recommendation was made to really drive home the importance of value for money of insurance in superannuation as part of the retirement incomes system. Properly done, it could be a game changer.

Other Safety Nets

It has been said by some that Workers Compensation and/or the Centrelink Disability Support Pension (DSP) provide adequate safety nets for people who experience disability. With respect, neither is relevant to the retirement incomes system.

Firstly, in relation to workers' compensation, such schemes are limited in their scope by only providing compensation for work-related injuries or sicknesses. By definition, any injuries and illnesses which occur outside of the workplace are simply not covered. The same applies to any motor accidents compensation schemes which limit cover to injuries in motor vehicle accidents.

Further, to the extent that workers compensation benefits may be payable, the purpose of such benefits is to compensate an injured worker for his/her inability to earn income during their working life. That is, workers compensation is a benefit payable in respect of an injured person's working life, and not in respect of his/her retirement.

In relation to the DSP, the eligibility rules were substantially tightened in 2011 such that many people who experience disability during their working lives and cannot work and accrue superannuation for retirement would not be entitled to the DSP. This is reflected in the low success rate in DSP applications.[12]

[11] Royal Commission into Banking, Superannuation and Financial Services Industry, recommendation 4.13.
[12] See Auditor-General Report No.13 2018-2019 Disability Support Pension – Follow-on Audit.

In addition, the DSP is a benefit payable in respect of someone during their working life. Once a person reaches retirement age, they are transferred to the Age Pension. Accordingly, the DSP cannot be said to be a benefit that is either readily available to someone who is unable to work due to a sickness or injury, or a benefit which in any way assists someone whose working life is cut short from accruing an adequate retirement income, independent of Government welfare.

Summary

It is our submission that insurance in superannuation is indeed an important part of the retirement incomes landscape in Australia and operates as an important safety net for people who experience disability.

It is essentially a self-funded means by which people whose working lives are cut short due to disability (or death) can still have adequate retirement incomes and not be dependent on the public purse for income support.

Insurance in superannuation has undoubtedly experienced problems in recent years which have the potential to unnecessarily erode retirement incomes. These problems have received much attention and substantial changes have been implemented, whilst others are still in train eg the Treasury consultation.

We will see the effect and benefit of these changes in the next few years.

As was recommended by the Productivity Commission in their report in 2019,[13] we submit that it would be appropriate to review insurance in superannuation in 2023 (i.e. four years from the date of the report). This would allow the reforms time to bed down and accommodate the usual three-year cycle for group insurance contracts.

It is important that we get this right to deliver equitable outcomes for people who experience disability and to make sure that they are not left behind in the retirement incomes system.

John Berrill
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[13] Productivity Commission Inquiry Report No. 91, 21 December 2018, recommendation 18.