



AUSTRALIAN INSTITUTE of  
SUPERANNUATION TRUSTEES

# Protecting Your Super package

**28 May 2018**

## **AIST Submission to Treasury**

### AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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### Executive summary

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**In brief:**

AIST generally supports the package, but changes are needed to better meet members' best interests. The fee cap calculation needs review and sell spreads need to be included in the calculation of exit fees in order to prevent gaming. The Insurance in Superannuation Voluntary Code of Practice should be the focus for improving member outcomes rather than the proposed legislation. Inactive accounts should be directly transferred to active accounts. A greater lead time is needed, given both process change and ATO processes already in train. AIST would appreciate further consultations to help better meet the proposals' objectives.

AIST supports the policy objective of preventing fees and insurance premiums unduly eroding peoples' retirement savings but contends that the package is a blunt instrument for achieving this objective.

- Both the calculation of the fee cap and of exit fees could be gamed. There is inconsistency across the industry as to the composition of fees and costs: ASIC has appointed an Expert to conduct a review. AIST believes that the outcome of this Review should be taken into account. In the meantime, AIST recommends that indirect costs be included in the fee cap calculation and that the sell component of buy/sell spreads be included in exit fee calculations.
- The Insurance in Superannuation Voluntary Code of Practice is being comprehensively implemented and should be the focus for improving outcomes for super fund member rather than the proposed legislation.
- The criteria for removing default insurance cover are too broad and limit the capacity of a fund to have regard to their members' best interests. AIST proposes better alternatives.
- Current improvements in data reporting to the ATO should be aligned and used to improve insurance in super and reduce multiple accounts and fee erosion.
- These data services should be used to support mandatory transfer of inactive accounts to members' active accounts, and not involve the wholesale transfer of members' money to the Government where members would not necessarily be earning a rate which would be in their best interests.

AIST would appreciate further consultations to discuss these implementation issues associated with the proposals.

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## Fee capping and exit fees

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### Introduction

AIST notes its strong support for proposals which have the objectives of reducing the undue erosion of smaller account balances and encouraging account consolidation.

AIST appreciates the scale of the issue. According to SuperRatings, of the funds they collect data from, 22.1% of the median fund's total accounts hold less than \$4,000, 4.2% hold \$4,001-\$6,000 and a further 6.5% have a balance between \$6,001-\$10,000<sup>1</sup>. Accordingly, AIST in general supports the proposals to remove exit fees and to cap fees on smaller accounts. We also support the level of the fee cap at 3%.

However, in implementing any such proposals, it is important that the principles of fairness, transparency and consistency are applied.

Our concerns with the proposals flow from five key issues:

#### **1. Fee capping may be gamed.**

There is inconsistency across superannuation as to what is a 'fee'. Different asset classes and different sectors are currently treated differently.

Additionally, currently entities may elect to treat a 'fee' as an 'indirect cost'.

These issues impact how many members may be covered, as well as enabling possible gaming of whether members fall under the cap.

ASIC has acknowledged that the issue of fee and cost disclosure requires investigation. Accordingly, ASIC has appointed an Expert to review how fee and cost disclosure could best meet the objective of greater transparency.

An interim solution while awaiting the outcome of this review would be to include indirect costs.

#### **2. Fee caps should be calculated on retrospective amounts to aid certainty and efficiency.**

To ensure greater transparency and efficiency, the fee cap should be calculated retrospectively and only once a year.

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<sup>1</sup> SuperRatings (2018). *Budget 2018: Proposed fee cap impacts*. [online] SuperRatings. Available at: <https://tinyurl.com/y8ha5wde> [Accessed 23 May 2018].

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### 3. Exit costs could be gamed.

The non-inclusion of the sell component of buy/sell spreads means that exit costs could be gamed.

This also affects how many members may be covered.

### 4. Cross-subsidisation across member cohorts will increase.

Given funds have fixed costs, members who do not come under the proposals will have to pay more.

### 5. Insufficient lead time.

Funds will need to undertake fee modelling and administrators will then need to change fees for each fund they administer (it will not be a global task). Once resolved, funds will need to prepare a mailout to members involving both fee and any insurance issues.

## Recommendations

AIST recommends:

Recommendation	Details
<b>1. That implementation be deferred pending the outcome of the RG97 Expert Review and ASIC's approach.</b>	Fee and cost disclosure including the composition of administration and investment fees are currently under Review. Current complexities and lack of consistency across the industry have been recognised.
<b>2. Alternatively, indirect costs should be included in the calculation of the fee cap, pending the outcome of the RG97 Expert Review and ASIC's approach.</b>	Currently, RG97 permits entities to elect that fees be disclosed as indirect costs – this facilitates gaming of the fee cap.
<b>3. The fee cap should be calculated on retrospective amounts.</b>	This would provide greater certainty to both members and administrative processes.
<b>4. That the Government consider whether the proposed fee cap be restricted to inactive accounts</b>	AIST recommends the Government consider whether the proposed fee cap for low balance accounts should be restricted to inactive accounts to avoid the unintended consequence of increasing costs to other members or cessation of engagement programs for new members.

<p><b>5. The sell component of buy/sell spreads should be included within the cost of exits.</b></p>	<p>Buy/sell spreads are a true cost of exits, and inclusion would assist with reducing the possibility of fee gaming.</p>
<p><b>6. Further discussions are needed regarding implementation timing.</b></p>	<p>Funds will need to reprice fees and may need to provide members with Significant Event Notices: insurance changes would also need to be included. Additionally, the RG97 Review outcome should be taken into account.</p>

We now turn to examining our key concerns.

### Fee capping may be gamed

#### Introduction

The *Treasury Laws Amendment 2018 (Protecting Superannuation) Bill 2018* ('the Bill') bases the cap on the total administration and investment fees to member accounts. Without amendment, this approach would result in not properly meeting the objectives of the proposals, and also could facilitate gaming.

First, we wish to highlight the current position of profit-to-member funds. The following data shows that implementation of the cap would affect fewer profit-to-member funds than retail funds at the higher end of reaching the \$6,000 level.

*Table: Proportion of funds exceeding the proposed fee cap*

Account balance	\$1,000	\$2,000	\$3,000	\$4,000	\$5,000	\$6,000
<b>All funds</b>	87.0%	83.5%	65.2%	38.3%	26.1%	21.7%
<b>Profit to member funds</b>	85.7%	80.0%	54.3%	21.4%	7.1%	2.9%
<b>Retail Master Trusts</b>	88.9%	88.9%	82.2%	64.4%	55.6%	51.1%

Source: SuperRatings<sup>2</sup>

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<sup>2</sup> Based on the funds from which SuperRatings collects data.

### **Composition of administration or investment fees is treated differently across the industry**

The Bill bases the cap on total administration and investment fees applicable to a member's account.

The composition of administration or investment fee is currently under review, along with other fee and cost disclosure issues. Following a long consultation process and a series of industry submissions, ASIC has appointed an Expert, Mr Darren McShane, to review *Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* ('RG97'). The Review<sup>3</sup> is to consider RG97, but may also lead to a consideration of the principles and law on which RG97 is based. The Review is scheduled to be completed and the report published by 30 June 2018.

Here are but some of the issues being considered. The outcome will affect what is included as an 'administration fee' or as an 'investment fee':

- Variance of treatment across asset classes. For example, direct and listed property are currently treated differently.
- Variance of treatment across sectors. For example, fees are treated differently between non-platform superannuation and platform superannuation.
- Whether entities should be able to elect to treat a fee as an indirect cost instead.

There are several important consequences from this lack of fairness and consistency:

- Members whose account should be caught by proposals will not be. This is particularly relevant to members currently invested in platform superannuation products, one of the fastest growing segments of the market. This is because there are currently different disclosure regimes between non-platform superannuation funds and platform superannuation funds.
- A longer implementation time is needed to enable the outcomes of the Review to be known.
- Entities may increase the use of elections to treat a fee as an indirect cost instead, thereby opening the potential for gaming of the fee capping proposals.

### **The cap should include the indirect cost ratio (ICR)**

AIST strongly recommends that the cap should include the ICR.

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<sup>3</sup> ASIC, RG97 Review. See <https://tinyurl.com/yawjtlum>

## Protecting Your Super Package

Firstly, the following table demonstrates why the ICR should be included, so that members may be better protected:

*Table: Proportion of funds exceeding the proposed fee cap including/excluding ICR*

Account balance	\$1,000	\$2,000	\$3,000	\$4,000	\$5,000	\$6,000
Proportion of funds excluding ICR	87.0%	83.5%	65.2%	38.3%	26.1%	21.7%
Proportion of funds including ICR	87.0%	86.1%	77.4%	52.2%	37.4%	25.2%

Source: SuperRatings

Secondly, currently under RG97, entities may elect to treat a fee as an indirect cost instead. This would enable entities to game the fee capping provisions.

Thirdly, for some funds, the ICR constitutes 100% of the asset-based fee component<sup>4</sup>.

### Profit-to-member funds prioritise engagement with new members

AIST wishes to note that the proposed fee cap detracts those profit-to-member funds which put significant efforts into engaging with new members. The following case study outlines the impact.

#### Example

Fund A expects that 14,000 new members will join the fund this financial year. As part of its onboarding process, the fund aims to engage with every new member. Engagement includes:

- Identifying and assisting the member to consolidate lost superannuation into their active account.
- Considering whether the member should switch investment options.
- Considering whether the member's default insurance cover is adequate or whether more or less cover is appropriate.
- Nominating beneficiaries.

Getting new members' superannuation affairs in order is of significant benefit to these members in an attempt to generate better overall outcomes for members.

<sup>4</sup> SuperRatings (2018). *Budget 2018: Proposed fee cap impacts*. [online] SuperRatings. Available at: <https://tinyurl.com/y8ha5wde> [Accessed 23 May 2018].



Providing these services costs money. These costs should be borne by the members who receive and benefit from this service.

Applying the proposed fee cap to active members who are new to the fund would mean the fund may not be able to recover the costs of this program from the members receiving these services. Instead, either these costs would be borne by active members whose balance had reached \$6,000 or the fund would be required to discontinue a valuable program which engages members with their superannuation, reduces the number of duplicate accounts members hold, ensures they are in an appropriate investment option and hold appropriate insurance cover.

AIST recommends the Government consider whether the proposed fee cap for low balance accounts should be restricted to inactive accounts to avoid the unintended consequence of increasing costs to other members or cessation of engagement programs for new members.

### **Fee caps should be calculated on retrospective amounts**

Under the Bill, the calculation of the account balance is to occur on the 'balance test days', which are to be envisaged to be 30 June and 31 December. AIST is concerned that this would have several detrimental impacts:

- Member account balances can both go up and down within the period.
- Under the current proposals, periodic adjustments would have to be made if the member's account falls within the \$6,000 cap. This would cause both system and administrative process problems.
- It would therefore be more efficient to apply the cap once a year, but take into account when determining the methodology that account balances can fluctuate.
- AIST recommends that the fee cap should be applied to a retrospectively determined account balance. This would provide greater certainty to both the member and entities' administration processes.
- AIST's recommendations would also obviate the need to have operating standards. The proposals refer to having operating standards to prescribe how the amount of the account balance is to be calculated: this would inject an element of unnecessary uncertainty into the process.

### **Exit costs could be gamed**

The proposals would prohibit exit fees, but specifically exclude the sell component of buy/sell spreads. AIST strongly recommends that the sell component of buy/sell spreads be included. Failure to include the sell component of buy/sell spreads would facilitate gaming as well as not truly reflect the cost of switching funds.

## Protecting Your Super Package

Buy/sell spreads are a cost of a member exiting a fund. This is reflected in standard definitions of buy/sell spreads. For example, Morningstar notes that ‘when an investor sells out of the fund, the fund manager may need to trade the fund's assets in order to meet investors' withdrawals. This activity involves transaction costs such as brokerage fees and bank fees, all of which are paid by the fund. These costs are reflected in a buy/sell spread<sup>5</sup>.’

The RG97 Industry Working Group’s Fee and Cost Disclosure Guidance<sup>6</sup> – a document issued by AIST, ASFA and the FSC notes that ‘a buy/sell spread is an amount charged by a trustee or responsible entity on unit holder application and redemption requests, in order to recover transaction costs incurred to meet the member’s request.’ Clearly, it is widely accepted that a buy/sell spread is a cost of the member exiting the fund.

Additionally, if the sell component of buy/sell spreads is not included in the prohibition on exit fees, there is the potential for gaming fees through increasing the sell spread. AIST has already heard anecdotal feedback from industry commentators that they will be keeping a very close eye on buy/sell spreads if the proposals are not amended to include them.

### An increase in cross-subsidisation

AIST notes that the proposals will result in increased cross-subsidisation. Funds will need to review their fee pricing.

#### Fee cap

In profit-to-member funds, there are no other entities as may exist within profit-driven vertically integrated structures within which to gain cross-subsidisation of, for example, administration fees. A cap on lower account balances will impact the fees of members with account balances over the cap. Given that **the amount of cross-subsidy may be quite high** (depending on the age demographic/account balance profile of the fund), **this cross-subsidy may be quite high**, which contradicts MySuper principles.

AIST notes that an option to manage this and to act in the members’ best interest may be to send the members’ moneys to an Eligible Rollover Fund.

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<sup>5</sup> Morningstar, *Understanding your fund: fees and charges*. Morningstar. Available at: <https://tinyurl.com/y94bfysvc> [Accessed 23 May 2018].

<sup>6</sup> AIST, ASFA, FSC (2017). *RG97 Industry Working Group Fee and Cost Disclosure Guidance*. [online] Available at <https://tinyurl.com/yacftv7> [Accessed 23 May 2018].

### Exit fee prohibition

Exit fees within profit-to-member funds are quite low, generally being a flat activity-based fee of under \$100. An exit involves processes such as checking proof-of-identify documents, the exit form itself, and processing the payment. Based on our research, between 5-10% of members exit a fund each year. As an example, in a fund with 100,000 members with an exit fee of \$50 and 10% of members exiting, the ban on exit fees would total \$500K each year.

### Insufficient lead time

The proposals set an implementation date of 1 July 2019. There are several issues which impact the feasibility of this implementation date:

- Funds will need to reprice their fees owing to increased cross-subsidisation. Once resolved, this will involve sending members a Significant Event Notice ('SENs') which would require a separate mailing which would also need to include insurance changes.. This would mean funds would have to reprice their fees by June this year, based on a Bill which has not yet passed, in order to have SENs ready.
- The RG97 Review is scheduled to have a report released by 30 June. Following that, ASIC has said that further consultations would take place. This process may have an impact on what comprises an 'administration fee or investment fee'.

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## Insurance for superannuation members

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### Key points

AIST supports the provision of default insurance through superannuation as an effective and good value way of providing basic insurance cover to the millions of Australians who would not otherwise have life insurance, or for whom it would be too expensive or inaccessible. Following a death or permanent disablement, an insurance benefit can make a significant difference to people's lives and without such insurance cover, there would be a higher call on Government funded benefits.

AIST recognizes that this must be done in a way that does not inappropriately erode retirement balances. Accordingly, AIST supports and is a co-owner of the Insurance in Superannuation Voluntary Code of Practice. The Code provides a better, more extensive and consistently member-focused approach to addressing insurance in superannuation issues when compared with the Budget proposals, and will result in better outcomes. Also, given that funds will have existing contracts which usually have a three-year rate guarantee, a longer transition period needs to apply

If the Government does intend to progress with this legislation, AIST recommends that the legislation should be modified so that it provides necessary minimum protections, especially for the most vulnerable.

Additionally, AIST notes that the legislation could detriment women. Women need to be covered while on extended leave, given that women take extended leave for parental and carers' leave. Also, it would take a new full-time member on an annual income of \$50,000 18 months to build an account balance of \$6,000 (unless they get a transfer in). It would take even longer for casual and part-time workers. Australia has one of the highest levels of female part-time workforce participation rates of OECD countries. AIST submits that this arrangement would therefore be detrimental to new employees, job changers, people returning from parental leave, and is likely to disproportionately affect women.

### Recommendations

Recommendations	Details
<b>1. That trustees be able to retain an ability to provide default cover to members aged between 21 and 24.</b>	Trustees should be able to set the commencement date depending on the needs of members and meet their best interests.

<p><b>2. The timeframe for inactivity should be extended to 16 months.</b></p>	<p>This will allow trustees to better meet the needs of members on parental leave and take into account SG payment cycles.</p>
<p><b>3. The separate low balance and inactivity criteria for removing default cover should be combined into one criterion.</b></p>	<p>So that a member’s account must be both inactive for 16 months and have a balance of less than \$6,000 for cessation of cover</p>
<p><b>4. A later commencement date than 1 July 2019 commencement, preferably 1 July 2020.</b></p>	<p>There needs to be recognition of:</p> <ul style="list-style-type: none"> <li>• The impact of restricting insurance on the risk pool.</li> <li>• Funds being required to revise pricing and enter into new arrangements with insurers.</li> <li>• The potential need for funds to issue Significant Event Notices regarding insurance arrangements.</li> <li>• Better and more up-to-date data will be available following implementation of ATO’s MATS/MAAS and STP projects.</li> </ul>
<p><b>5. The scope of MAAS reporting project should be extended to require greater fund reporting of member insurance arrangements to the ATO.</b></p>	<p>This will:</p> <ul style="list-style-type: none"> <li>• Increase member awareness of insurance in super and the benefits it provides.</li> <li>• Be used to reduce the incidence of multiple insurance cover.</li> </ul>
<p><b>6. The Bill should include a carve-out for employer-paid insurance premiums.</b></p>	<p>The only consequence of not providing a carve-out would be to remove an employee benefit.</p>

### Details of AIST recommendations

#### **The Insurance in Super Code of Practice provides a wider range of consumer protection**

The insurance in super proposals in the Budget are narrower than the measures in the Insurance in Superannuation Voluntary Code of Practice for superannuation trustees. The Budget proposals are a blunt instrument, the implementation and operation of which may be unnecessarily disruptive, and will not be in members’ best interest unless some modifications are made.

The Code improves superannuation member value and protections, and includes:

1. A framework that sets expectations about the maximum amount of superannuation contributions that should be used for automatically provided life insurance premiums.
2. Simpler and clearer processes for members to opt out of automatic life insurance.
3. Simplified disclosure and improved superannuation fund member communications about insurance.
4. Requirements to reduce multiple insurance policies by cancellation of some insurance cover, after funds contact members in cases where member accounts are inactive and insurance exists.
5. Provision of better and more timely assistance to members during claims.
6. Standards for handling of premium adjustment amounts between insurers and trustees.
7. Requirements for trustees to publish plans for the Code implementation and when various aspects of it will be implemented.

The Code is now the joint property of AIST, ASFA and FSC, and the industry bodies are working co-operatively on the implementation of the Code. Almost all AIST members made statements of intent to subscribe to the Code by the end of the March quarter 2018, and we understand that the other bodies have also recorded high take-up levels.

Approximately 92% of MySuper members will be covered by the Code, and subscribing funds are in the process of preparing transition plans. These will be completed by the end of 2018. A transition committee of super funds, insurers, administrators and code owners (including AIST) is facilitating implementation by assisting trustees in interpreting and meeting their commitments under the Code.

Trustees have a fundamental legal obligation to ensure that their super fund acts consistently with their trustee duties and decision-making obligations. A trustee is required to act in members' best interests and cannot apply a provision in the Code where it would be inconsistent with this.

This is a test that will be applied by all trustees, and will form part of the processes involved in preparing fund transition plans. However, in most instances, AIST anticipates that funds will be able to apply all aspects of the Code without modification.

A fund that applies a provision of the Code in a modified form will need to be able to demonstrate that the modification is required in order to be able to meet their paramount members' best interests requirement. Of course, as entities covered by the SIS Act, all subscribers to the Code must also ensure that insurance premiums do not inappropriately erode the account balances of their members.

### **Opt-in insurance for younger members should have regard to their characteristics**

AIST supports special default insurance arrangements for younger members, including the provision of insurance on an opt-in basis for members below a specified age. This is the subject of detailed consideration in the Insurance Code.

The Insurance Code provides that

*4.10 For **younger** members, when designing benefits we will consider:*

- a) appropriate types and levels of cover, given that **younger** people are less likely to have children and other dependants or significant debt, and are more likely to require total and permanent disability or income protection, rather than death cover*
- b) the impact of premiums on members who typically have low account balances*
- c) the likelihood that **younger** members will be earning significantly lower salaries than older members*
- d) working patterns, which may be casual or part-time*
- e) fair treatment of **younger** members, taking into account whether there is any cross-subsidisation by premium with older members of the fund,*

*and as a consequence of the above considerations, it is expected that levels of cover or premiums will be lower for younger members than for the membership generally.*

In response to these requirements, funds subscribing to the Code are reviewing the needs of their members and are making changes accordingly. This is a work in progress. However, it is already clear that different membership cohorts will have different needs.

AustralianSuper, for example, has made changes to its insurance benefit structure so that insurance is not held in new accounts for under 25 year olds. Default cover for these members commences when they either turn 25 or elect to receive cover.

However, building industry super fund, Cbus reflects their members' needs and typical life circumstances and defines young members differently from other funds. By the time their members reach 21, many have been in the workforce for 3-4 years and often have dependants. Most death claims made in relation to Cbus members over the age of 21 years are paid to their dependents.

Unlike the Code, the proposed legislation does not give trustees the capacity to consider the particular needs of their younger members and allow them to tailor their insurance offerings accordingly.

While it is much more likely that young people in Australia under the age of 21 will not have dependants or mortgages, the circumstances of people in their twenties is likely to be more

varied, and reflected in different ways in different funds. Accordingly, trustees should have discretion in relation to default cover for members aged between 21 and 24, and AIST submits that this be reflected in the legislation.

### **Ceasing insurance for low account balance members should be accompanied by inactivity**

AIST does not support default insurance being removed from an account solely on the basis of a low account balance.

If insurance cover only commences when a new employee builds an account balance of \$6,000, this will take a new full-time member on an annual income of \$50,000 18 months to build that balance unless they get a transfer in, and longer for casual and part-time workers. AIST submit that this arrangement will be detrimental to new employees, job changers, people returning from parental leave, and is likely to disproportionately affect women.

Consistent with the Insurance Code, AIST submits that low account balance accounts should only have automatic insurance cover ceased after a period of inactivity, unless the member advises they wish to keep the cover.

This would also ensure that insurance cover is provided to new members. This would give them cover during the time when they are building their account balances when they commence employment and are continuing to receive contributions, but would mean that cover is ceased after a period of inactivity.

AIST submits that the legislation or associated regulations should include further consumer protections about ongoing requirements to advise members, reflecting communications provisions of the Insurance Code. The requirements in the Code are as follows:

- 4.24 *If we stop receiving contributions to your account, we will contact you no later than 6 months after receipt of your last **eligible contribution**.*
- 4.25 *The communication will be **in writing** and will include:*
  - a) *general information about the impact of insurance premiums on retirement savings when there are no longer contributions*
  - a) *an explanation that if you have started contributing to another fund, you may be over-insured, and that if you hold multiple income protection covers, you may be unable to claim on more than one benefit*
  - b) *information about the impact of losing cover*
  - c) *a request for your consent to cancel your cover in order to avoid eroding your account balance*
  - d) *for **Automatic Insurance Members** who hold income protection cover, our intention to automatically cease your income protection cover 13 months from the date of your last **eligible contribution**, unless you advise us you wish to keep this cover*



- e) for **Automatic Insurance Members**, if we determine that you are likely to have an account balance of less than \$6,000 13 months from the date of your last **eligible contribution**, our intention to automatically cease your death and total and permanent disability cover at this time, unless you advise us you wish to keep this cover
- f) your options to cancel your cover immediately, reduce your cover, or keep your cover.

### Example

Sophie is 32 years old with two pre-school children, and has re-entered employment after a lengthy break. She works part-time (25 hours per week) waiting on tables at a lunch time café, and is paid award wages and SG contributions by her employer. Sophie has no life insurance.

Based on her annual wage of \$24,547, her employer contributes \$2,332 to her default super fund each year. It will take Sophie over 2 ½ years to accumulate \$6,000 in her super account, and during this time will have no death or TPD insurance.

Sophie seeks to protect her family and purchase cover after being employed for 18 months, with a balance still below \$6,000. However, she learns that she will have to pay higher premiums than previously available through default cover arrangements. Sophie presents a higher risk profile than a new employee being given default insurance cover.

### **Better data and less multiple accounts should be the main focus to reduce insurance premium erosion**

The proliferation of multiple accounts and multiple insurance premiums is not a function of the default fund system as suggested in the Explanatory Material. It is function of successive governments not implementing all of the elements necessary for the efficient operation of a default system, including the consolidation initiatives arising from Stronger Super. If these elements had been implemented earlier, these issues would already have been largely addressed. Additionally, and there would be less erosion of account balances through fees and fewer numbers of unnecessary multiple accounts. This will be addressed in more detail in the section below on inactive accounts, and AIST will make comments specific to insurance in this section.

When a super fund establishes a new account for a member, the fund uses ATO and other services to verify the identity of the member and confirm member details. Funds and members can also use the ATO SuperMatch service to locate and consolidate their other superannuation accounts.

## Protecting Your Super Package

However, there is no way at present for a super fund to know if a new member has insurance through another super fund. A fund could ascertain this information if the scope of the MAAS project was extended in a new stage to including fund reporting to the ATO on insurance.

AIST proposes that the ATO commence consultations with the superannuation industry about the mandatory reporting of a member's insurance, including whether they have default cover or additional cover, the number of units of death, total and permanent disability cover, and income protection cover as well as the value of this cover.

This near real-time information could then be accessed by super funds when processing new member applications, and could assist with communications sent to these members about the totality of their insurance cover. This would increase member awareness about insurance, support members having adequate levels of cover, while also ameliorating the establishment of unnecessary multiple insurance cover.

### **Transitional issues need to be managed to avoid insurance shocks**

Changing default group insurance cover as proposed by the draft legislation and with its implementation timeframe would have a very significant impact on the Australian group insurance market and consequently consumers.

It is expected that the take-up rate amongst young people would be very low, even amongst those with dependants and mortgages. Fewer people would be insured because of the inactivity and age-related proposals. From an insurer's perspective, this will markedly change the composition of the risk pool and will increase costs. These costs will be passed on to the members as higher premiums and increase the cost of accessing insurance for many members.

Implementation of these measures will require changes to fund documentation, such as Product Disclosure Statements and the distribution of Significant Event Notices. Much more significantly, however, will be the impact on existing group life policies. These will need to be reviewed and repriced in light of the changes. It is highly likely that these changes will force a significant increase in premium costs. Most group risk policies have a life of between 3 and 5 years

In light of this, AIST recommends that implementation of these measure be deferred until the later of 1 July 2020 or from the end of insurance policies commenced prior to Budget night.

Additionally, implementation arrangements may be influenced by the Productivity Commission inquiry into the competitiveness and efficiency of the superannuation system. The final report of this inquiry is due later this year and will include observations and recommendations about the structure and operation of insurance in superannuation.

## Protecting Your Super Package

As the Government may make further policy announcements in response to this report, AIST submits that it would be more efficient to consider and respond to all of the relevant proposals at the same time. This supports the above recommendation for a deferral of these measures.

### **Employer paid premiums**

The Bill should include a carve-out for employer-paid insurance premiums, regardless of a members' age or their account balance. Default insurance should be permitted for members where premiums are paid for by an employer. In such cases, default insurance cannot contribute to account balance erosion. The only consequence of not providing a carve-out would be to remove an employee benefit.

## Inactive low-balance accounts and consolidation into active accounts

### Key points

AIST supports measures that prevent account erosion and the proliferation of multiple accounts. To this end, AIST agrees there is a need to use a form of auto-consolidation to reunite members with inactive accounts.

### Recommendations

AIST:

Recommendations	Details
<p><b>1. Supports both super funds and ATO being given greater powers to consolidate accounts with members' active account, without a member's request.</b></p>	<p>Regulatory constraints to consolidation have been gradually removed since 2011 as part of SuperStream but need to be accelerated to fix this problem. Solutions could include either putting a cap on the period of activity or through allowing a renewable flag on a member's account as an indicator to exclude the account from consolidation.</p>
<p><b>2. Opposes the proposed mechanism of transferring money as well as data to the ATO.</b></p>	<p>The Government proposal would result in significant amounts of members money being transferred not to members but into consolidated revenue.</p>
<p><b>3. Supports a mechanism based on direct fund-to-fund transfer of inactive accounts to active accounts, based on data provided by the ATO to funds, as an alternative.</b></p>	<p>This will result in money being directly transferred into the active accounts of members, rather than joining the \$4 billion of 'unclaimed super' current held by the Government.</p> <p>It would also result in the member having the benefit of retaining their insurance cover in at</p>
<p><b>4. Supports an ongoing role for Eligible Rollover Funds that facilitate this process, particularly in the context of the proposed fee cap for low balance accounts.</b></p>	<p>The ERF providing services to profit-to-member funds has a long and successful track-record of reuniting people with their lost super, and in updating address details.</p>

<p><b>5. Recommends giving effect to the above initiative by an amendment to the definition of inactive members in the lost members part of the SIS Regulations.</b></p>	<p>The proposals should be integrated into the existing framework for lost and unclaimed super, rather than overlay new and different requirements.</p>
<p><b>6. Recommends specific time requirements for both ATO and super funds within which to action steps in the auto-consolidation process.</b></p>	<p>Benchmarking and regulatory service standards have assisted members through faster and more efficient transactions.</p>
<p><b>7. Recommends the timeframe for inactivity be extended to 16 months.</b></p>	<p>This will allow trustees to better meet the needs of members returning from parental leave.</p>
<p><b>8. Recommends that some forms of member engagement should render an account active and requiring any request for exclusion to be regularly renewed.</b></p>	<p>The proposals should recognise and support member engagement, by acknowledging activity rather than receipt of contribution.</p> <p>There should be a review to ensure that flagging member activity is not gamed.</p>
<p><b>9. Support a later commencement date than 1 July 2019 commencement, preferably 1 July 2020.</b></p>	<p>Funds will be required to revise pricing and enter into new arrangements with administrators, as well as drawing up and issuing Significant Event Notices.</p>
<p><b>10. Recommend a pilot for transfer of inactive accounts for operational reasons during the 2019-20 financial year, followed by a phased implementation from 1 July 2020.</b></p>	<p>A longer transition timeframe is required, as:</p> <ul style="list-style-type: none"> <li>• Funds will be required to revise pricing and enter into new arrangements with administrators.</li> <li>• Better and more up-to-date data will be available following implementation of MATS/MAAS and STP.</li> </ul>

### Details of AIST recommendations

As the Explanatory Material notes, 40% of existing superannuation accounts have balances of less than \$6,000. A high proportion of these are inactive and will be impacted by this measure.

AIST supports measures to protect low-account balance inactive members but suggests there are ways to improve both the structure and implementation of the measures.

### Support for account consolidation measures

AIST has long recognised that fee erosion and unnecessary superannuation accounts can have a significant impact on individuals' retirement savings, and that this can be addressed in part by the auto-consolidation of accounts. This recognition has been demonstrated in active participation and support for consolidation initiatives arising from the Stronger Super package of reforms, and more recently, SuperStream.

There has been a steady reduction in the number of unnecessary and lost superannuation accounts since June 2010 when there were 33 million accounts in Australia. This has been a function of both the implementation Stronger Super and SuperStream initiatives<sup>7</sup> and actions undertaken and promoted by profit-to-member super funds, such as the cross-fund-matching activities.

In the four years to 30 June 2017, about 1.68 million accounts with a total value of \$8.12 billion have been consolidated, transferred or claimed as a result of these activities. The partnership between the ATO and the super industry to achieve these results has been acknowledged by the ATO:

*It is and always has been in our interests to reunite people with their super, whether lost or unclaimed. Indeed, I think we have a great partnership with industry which, while not a new arrangement, is ongoing and continually improving<sup>8</sup>.*

Not all of the consolidation initiatives arising from Stronger Super were implemented, and this has resulted in there continuing to be issues with fee erosions and unnecessary numbers of multiple accounts.

For example, in 2011, the then Government announced the following auto consolidation initiative:

*Members will have a streamlined process to consolidate accounts and avoid paying unnecessary fees, including insurance premiums, on multiple accounts. Any accounts with less than \$1000 will be automatically consolidated to the current active account unless the member opts out.<sup>9</sup>*

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<sup>7</sup> On overview of these benefits can be found at <https://is.gd/lDb36P>

<sup>8</sup> James O'Halloran, Deputy Commissioner, Superannuation, ATO, Journey through reform for ATO and APRA superannuation funds, 14 March 2018. <https://is.gd/oeu2ma>

<sup>9</sup> <https://is.gd/mzrZln>

AIST was involved in the consultation process that led to this initiative and supported its implementation.

AIST does not agree with the comments in the Explanatory Materials that the high incidence of duplicate accounts is a consequence of the current default MySuper default settings. The issue of multiple accounts predates the MySuper reforms; the Stronger Super reforms of which MySuper is a part included measures to address these issues. These measures have had some success, and AIST supported further measures to address these issues.

### **Inactive accounts should be directly transferred to members' active accounts**

AIST supports the reporting of inactive/low account balance information to the ATO, and for the ATO to use this information to support the transfer of these accounts into members' active accounts.

This process should be as quick and efficient as possible, and AIST submits that there is a better process to achieve this outcome than the wholesale transfer of account balances to the ATO. This alternate approach uses functionality that is currently being implemented by the ATO and super funds.

The process should be as follows:

- Funds are required to report account transactions to the ATO on a near real-time basis as part of MATS reporting from April 2019, and are reporting account attribution details from later in 2018 as part of MAAS reporting.
- From this information, the ATO is able to ascertain (amongst other things):
  - Account balances
  - Date of last contribution
  - Changes to member details
- The ATO is able to determine when an account has a balance and level of inactivity that meets the criteria for consolidation, and if the account owner has an active account.
- This information can be used to trigger a report to the fund with inactive members identifying these members, and include a direction to transfer the account to the relevant active account (based on the priority order specified in the regulations).
- There would be no requirement for monies to be sent to the ATO. The transfers would move directly from one inactive account to an active account in the same name.
- The turnaround time for this process avoids unnecessary double-handling, is efficient and leverages off a nascent functionality, and would be much faster than that anticipated in the budget proposal, and would retain monies in the superannuation system.

AIST submits that this process can be given certainty by making both the ATO and super funds accountable for the process. This process should include legislated timelines for the ATO reports to be actioned by funds (i.e., by transferring the balances to the appropriate active account).

### **Definition of inactive members**

The proposed change amends the *Unclaimed Money and Lost Members Act (SUMMLMA)* but does not amend the lost member definition in the SIS Regulations. This means that a new category of inactive members is being created, while maintaining the SIS Regulations definition of lost members that also includes an inactive component.

As a simpler alternative, AIST recommends amending the SIS Regulations rather than the SUMMLMA. The SIS Regulations could be amended by deleting inactive part of the lost member definition, and requiring eligible providers to pay balances of less than \$6,000 to the ATO where the account was created more than 2 years ago as a standard employer sponsored member, and has been inactive for 16 months. AIST does not propose maintaining the existing 'positive act' provision in the Regulations.

As well as avoiding making an already complicated definition even more complicated, this approach also has the following merits:

- Applying a low balance/inactive account rule in line with the Budget announcement.
- Replicating important elements of the existing definition of inactive members.
- Maintaining the existing qualification of having joined more than 2 years ago as a standard employer sponsored member.
  - This will allow new members to build up an account balance even if they have periods of inactivity.
  - It will also allow super funds to transfer accounts to Eligible Rollover Funds (such as AUSfund) in order that they can also contribute to the process of reuniting people with their inactive super accounts.

### **Member activity should be more broadly defined and members should be able to opt-out of auto-consolidation**

AIST submits that there can be more to a member's engagement with their super fund than transactional activity around the receipt of contributions. Accordingly, we argue that demonstrated engagement with the fund may include the member changing their details or seeking financial advice, and that such activity should also preclude their accounts from being included in the auto-consolidation process. AIST recommends further consultation with industry with a view to reaching a consensus on the appropriate parameters for eligible engagement.



However, we do not support SIS Regulation 1.03A(1)(e) being used to permanently exclude a member from being declared lost or inactive as the inactive member has indicated by positive act that they wish to continue to be a member of the fund. For example, a member may wish to keep a low balance account open to access the insurance available from the account.

AIST is concerned that the positive act rule is susceptible to abuse and proposes further consideration of an appropriate flag to exclude an account from auto-consolidation. This maybe a temporary exclusion that has to be renewed each 3 years.

### **Period of inactivity**

For the purpose of account consolidation, AIST submits that the period for inactivity should be extended from 13 to 16 months. This is needed to ensure that employees who have an entitlement to 12 month's unpaid parental leave are not discriminated against by having their superannuation transferred to the ATO without their consent.

The 16 month recommendation is based on a twelve month period of leave plus consideration for employers that may pay superannuation contributions quarterly. The following example illustrates the inequity and inconvenience of a 13 month criteria:

#### **Example:**

Madeline is a part-time worker who returned from a period of 12 months unpaid leave on 1 January 2020. She had been paid all of her entitlements prior to the 2018 Christmas break, but still has a superannuation account balance of less than \$6,000. Madeline is being paid her salary and her employer is provisioning for her superannuation.

Her employer pays its Superannuation Guarantee contributions quarterly. Her employer pays Madeline's contributions for the March quarter 2020 on the due date of 28 April 2020. Her contribution is to be applied to her account by 1 May 2020, however, her account was transferred to the ATO on 30 April as an inactive, low account balance account.