HESTA Submission - Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 – July 2019

This submission is made by H.E.S.T. Australia Limited ABN 66 006 818 695 AFSL No. 235249, Trustee of Health Employees Superannuation Trust Australia ('HESTA') ABN 64 971 749 321. The content of this submission is information only, and it not is intended to be taken as financial, legal or any other advice, and should not be relied on as such. This submission includes information taken from sources considered reliable. While every attempt has been made to ensure the accuracy and reliability of the information, it is not guaranteed in any way. This submission is based on information available at 12 July 2019.

Summary

HESTA welcomes the opportunity to provide feedback on the *Treasury Laws Amendment (Putting Members' Interests First) Bill 2019*.

We make this submission as a super fund with a strict profit-to-members model, therefore making no material gain by the provision of insurance through a third party.

HESTA disagrees with the premise of the Bill and believes that 'opt-out' group insurance in superannuation has provided significant benefits through basic low cost insurance cover to millions of Australians that would be unattainable individually – these benefits would be significantly eroded if the Bill was passed in its current form. Any changes that diminish the insurance cover within super will need to be met by taxpayers through the social security system.

The proposed changes will significantly amend the 'value' that insurance offerings can provide to superannuation members. In many cases insurance will become less affordable and potentially unavailable for some cohorts. This Bill has a myopic focus on the cost of insurance and loses sight of the long-term value and protection it provides to individuals and society.

Essentially, the Bill proposes a simplistic solution to a complex problem. Assuming or arguing that people who need insurance will simply 'opt in' is a nice idea but not necessarily supported by the reality of disengaged members.

We also note that the Senate Economics Committee Inquiry was initially scheduled to report in October but on 10 July this was changed to 23 July. This timeframe is extremely short and provides insufficient time for serious consideration of the Bill, particularly the interplay with the first round of Protecting Your Super changes to remove insurance from inactive members and transfer inactive low balances to the ATO for auto-consolidation. These important reforms are still being implemented and should be given sufficient time to take effect and be assessed before more changes are enacted.

In summary, HESTA has significant concerns regarding the Bill, including;

- the fundamental undermining of the benefits of group insurance provided through superannuation, especially tailored industry specific insurance;
- the detrimental effects on new members under 25 years of age;
- the removal of valuable insurance for members with balance less than $6,000;
- the unrealistic timeframes for implementing the Bill;
- the increase in premiums that will inevitably occur;
- consumer confusion that will occur given the timing of recent Protecting Your Super (PYS) communications and Putting Members Interests First (PMIF) communications;
- interaction between PYS 'opt-ins' and PMIF 'opt-ins'; and
- the lack of time given to allow for consolidation of 'inactive accounts' to occur before rushing ahead with further changes.

We welcome the opportunity to discuss our submission further. Should you have any queries please contact James Bennett on (03) 8665 9217 or jbennett@hesta.com.au

About HESTA

Health Employees Superannuation Trust Australia ('HESTA') is an industry superannuation fund, established in 1987 to provide retirement benefits for workers in the Health and Community Services Sector. HESTA has approximately 840,000 members and over $50 billion of assets.

HESTA exists only to benefit members. As an industry fund profits go back into the fund to benefit members, not shareholders.

HESTA offers a MySuper product that is a no-frills, low-fee option for members. This includes the provision of default insurance provided by a third party insurer. The insurance offering has been designed to provide genuine benefits to our members who are primarily working in the Health and Community Services Sector. Members receive default death cover and default long-term income protection cover which pays a benefit until they are 67 years of age.

The typical HESTA member is a female aged 43 working in the services of those who are ageing. Because of the nature of wages in the Health and Community Services Sector, her broken work pattern and her time spent in an unpaid capacity caring for others, she has a balance of approximately $22,000 in superannuation.

Group Insurance

Automatic group insurance in superannuation has been a successful policy for Australia by providing a safety net for those who would otherwise be completely uninsured. Any changes that diminish the insurance cover within super will need to be met by taxpayers through the social security system.

HESTA strongly supports the provision of group insurance to members of *MySuper* products that is appropriate to the membership of each superannuation fund and consistent with maximising retirement benefits to members. We note that Trustees are already obliged to offer appropriate and affordable insurance based on the demographics and needs of their members.[1]

Rainmaker estimated the average cost for default life insurance in superannuation to be $3 per week and even less for younger members.[2] This is far better than any offering that an individual could obtain themselves in the market. Group insurance allows people to access a base level of cover at prices they could not possibly hope to find if they bought it directly, and often covers previously existing conditions, which retail insurance almost never does.

This way of providing insurance has been identified by Treasury as supporting the Government's objectives for the superannuation system of adequate default insurance and maximizing the retirement benefits of members.[3]

Insurance products within super accounts are provided either as a default setting, or as an option for the account holder to choose. The default setting means people must 'opt-out' if they do not want it, while if it is left as a choice it is 'opt-in'. This distinction is important because most account holders do not engage with super products in a detailed way. If products are 'opt-out', more people will be insured. If they require people to 'opt-in', there will be far less insurance.

Making a decision to 'opt-out' ("default") rather than 'opt-in' can dramatically change behaviour. A prominent example is France's organ donation system, which has been 'opt-out' since the beginning

[1] *Superannuation Industry (Supervision) Act 1993* (section 52(7)) and APRA Prudential Standard SPS 250 *Insurance in Superannuation*.
[2] *Rainmaker 2018* - http://www.medianet.com.au/releases/165283/
[3] Australian Treasury (2011) *MySuper consultation working group: Issues paper on insurance,* p 3-4, https://strongersuper.treasury.gov.au/content/consultations/working_groups/mysuper/IP_insurance_mysuper/downloads/IP_MySuper_Insurance.pdf

of 2017. Around 150,000 people in a country of 66 million opted out, a rate of 0.2%.[4] By contrast, less than half of Australians are registered on our National Organ Donor registry.[5]

Insurance purchased within superannuation is significantly cheaper than comparable insurance purchased outside superannuation, for several reasons. Superannuation funds can pool risk with little to no underwriting. Bundling insurance in superannuation substantially increases the number of people insured. This spreads the risks to the insurance provider and hence decreases the costs. These savings can be passed on in the form of lower premiums.

Pooling a risk reduces the need for underwriting. Different people have different chances of having to claim on an insurance policy. Some people might be at higher risk because of the types of work they do or lifestyle choices. Pooling risk means that workers with all kinds of risk profiles are pooled together. This allows higher risk workers to get insurance at a lower price who might otherwise struggle to get insurance because of their risk profile.

There are tax advantages to purchasing insurance within superannuation. The money within the superannuation fund is taxed at a concessional rate. Insurance premiums held within superannuation can also be fully or partly tax deductible. The result is that insuring within superannuation is more tax effective than holding the same policies outside superannuation.

There are also economies of scale for bundling insurance in superannuation. This includes decreased costs because of low cost distribution and simpler product design. The result of these reduced costs is lower premiums to consumers. Industry analysts estimate insurance policies through superannuation are 20 to 60 per cent cheaper than comparable cover purchased outside of superannuation.[6]

There is also a cash flow advantage for purchasing insurance within superannuation. The insurance is paid out of funds within the super account and so paying for the insurance does not impact on the workers day to day cash flow. Some workers, particularly those on low income, may find paying for this insurance difficult if it was not paid within superannuation.

APRA recently released statistics showing that group insurance through superannuation admitted more claims for members on a percentage basis in 2018 than those insured outside of super.[7] For insurance provided within super 98% of death claims were paid, for total and permanent disablement 88% were paid and for income protection the figure was 96%. This was higher than for someone who obtained insurance outside of super, including people who obtained personal financial advice – this is significant given personal financial advice should, in theory, provide better and more relevant cover for a person.

Group insurance through super outperforms individual insurance in all aspects. These significant savings mean that Australian workers have more insurance than would be the case if it was not available within superannuation.

The provision of group insurance to all members is an important pillar of the retirement system. HESTA recommends the "*Putting Member's Interests First" Bill* be removed from consideration by the Parliament.

[4] Willsher (2017) *France introduces opt out policy on organ donation,* https://www.theguardian.com/society/2017/jan/02/france-organ-donation-law

[5] Total registrations of 6.4 million as of August 2017. Department of Human Services (2017) *Australian Organ Donor Register statistics,* https://www.humanservices.gov.au/organisations/about-us/statistical-information-and-data/medicare-statistics/australian-organ-donor-register-statistics

[6] Productivity Commission (2016) *How to assess the competitiveness and efficiency of the superannuation system,* p 153-154

[7] *Life Insurance Claims and Disputes Statistics December 2018 -* https://www.apra.gov.au/publications/life-insurance-claims-and-disputes-statistics

Insurance value at HESTA

Currently, a 20 year old HESTA member would automatically receive:

- IP cover that provides $950 per month until age 67 if they are unable to work; and
- Death cover to the value of $50,000.

This cover is provided for 76 cents per week or $39.52 per year. HESTA receives a tax rebate for the cost of providing this insurance, which we pass on to members, meaning the cost of cover is effectively ***65 cents per week or $33.80 net per year***. These premiums remain at that level until a member turns 25.[8] Cover can be increased or cancelled at any stage.

Approximately 71,000 HESTA members are under 25 and can benefit from this low cost insurance cover. If future members under 25 were excluded from the group insurance pool then premiums would need to be adjusted and many young members would be uninsured.

Insurance design

HESTA members are some of the most vulnerable and marginalised workers in Australia. With our member base in mind we designed an insurance structure that is affordable and appropriate for their age and occupation. Our insurance, provided through a third party provider, currently AIA, gives low-cost default insurance consisting of Income Protection (IP) and Death Cover.

The provision of income protection through insurance (rather than a TPD lump sum), is the most sensible and manageable structure for our members. In addition IP encourages rehabilitation and an ongoing relationship with the member and naturally incentivises return to work through occupational rehabilitation.

We provide low-cost default insurance, IP to age 67 and Death cover to age 75. This is different to the majority of superannuation funds who mainly provide Total Permanent Disability (TPD) and Death cover as their default or automatic arrangement.

Under 68AA of SIS Act we are required to provide *MySuper* members with a benefit in the event of death and permanent incapacity. Our IP insurance pays an indexed benefit to age 67 in the event of permanent incapacity and thus satisfies the requirement for a benefit on permanent incapacity.

We have chosen our unique structure for three main reasons:

1. Our members typically draw a wage and are usually in a traditional employment arrangement under a collective agreement or award. They are predominantly light blue/blue collar workers and are often required to lift and perform manual tasks as a part of their role. An insurance arrangement that provides a replacement wage is most appropriate. TPD is typically paid in a lump sum to members who are then required to manage that money in a manner that provides for the continuation of a typical working life. This is a difficult task for even the most experienced of investors.

2. HESTA has a well-designed IP offering that often helps members more than TPD over time. Under the HESTA structure, this period of time matches a typical working life – that is, up until the age of 67 when a member can then access social security benefits. These instalment amounts are indexed, so the investment challenge does not rest with the member – it stays with the insurance provider.

   A member receiving IP payments who then dies is entitled to a death benefit. A member who has received a lump sum TPD who later dies is entitled to the death benefit LESS the TPD amount. TPD and Death covers are related and off-set one another. This is not the case with IP and Death benefits.

[8] HESTA Product Disclosure Statement – Page 11 - http://hesta.com.au/pds

3. IP encourages rehabilitation. The HESTA IP structure encourages a continuing relationship with the member and naturally incentivises return to work through occupational rehabilitation. The best chance our members have of a dignified retirement is long and meaningful participation in the workforce. Our members are skilled and motivated.

The most appropriate insurance structure for them is one which encourages and provides mechanisms to aid this participation. Our IP cover supports early rehabilitation intervention and effective return to work programs to promote and restore positive health outcomes for our members.

This design is useable regardless of work classification which is important so that our members can make claims even if they are employed on a casual basis. Many superfunds have similarly tailored their approach to insurance design to ensure it is equally as appropriate for their member base.

General impact of the proposed changes

If 'opt-out' insurance is delayed until an account exceeds $6,000 then it will create a series of unavoidable and costly administration and insurance risk management issues. Anti-selection is common when insurance is 'opt-in' as opposed to default due to higher risk members will choose insurance and lower risk members will not. Inevitably this will increase premiums for insurance in super and members will not have cover for significant periods of time after they join a superannuation fund.

We note that in 2018 (when these measures were first proposed) there was research conducted by Rice Warner and KPMG that concluded any overall benefits were likely to be minimal.

AIA, a leading insurer, commissioned by Rice Warner to examine these proposals and the longer term impacts on individuals' retirement balances.[9] In the scenario of 'opt-out' insurance being deferred until age 25 Rice Warner concluded that a marginal 0.27 per cent improvement would occur in retirement balances. This was based on a premium rates rise of 15 per cent, as estimated by Rice Warner as a result of the change in risk pooling.

The KPMG analysis[10] concluded that removing default cover for members with balances below $6,000 would result in premiums increasing by 20%.

HESTA Members

The proposed changes to exclude new members under 25 and all members below $6,000 will potentially have a significant detrimental impact on HESTA members.

Cover for under 25's is effectively 65 cents per week or $33.80 net per year. Over the last 10 years HESTA insurers have paid a death or disability income benefit to a member aged under 25 every 12 days, on average.

Due to the nature of our industry sector and the low wages of our members, it takes approximately 24 months for them to reach a balance of $6,000, leaving them potentially uninsured for two years. Most of our members do not have personal insurance cover outside of super which makes the provision of affordable and tailored insurance even more valuable.

There are currently 177,742 HESTA members with a balance under $6,000 – any insurance they hold could be removed as a result of this Bill. Approximately 75% of these members are women

[9] AIA 2018 - http://www.aia.com.au/en/individual/about-aia/media-centre/press-releases/2018/consequences-for-young-active-members.html
[10] https://assets.kpmg.com/content/dam/kpmg/au/pdf/2018/insurance-in-superannuation-impact-2018-federal-budget.pdf

and their average age is 36, meaning the average value of their lost benefit is potentially over $500,000 in combined default death and long-term income protection.

Due to the nature of our membership, around 6% of our members will probably never reach a balance above $6000. For these members, the insurance component of their super is far more valuable than the additional retirement benefit that would have accrued if they didn't pay the insurance premiums.

Implementation timelines & issues

The speed at which these measures are being put through the Parliament and the proposed timeline for implementation is likely to result in adverse consequences.

The Bill cannot be passed until late July (at the earliest) and has a proposed commencement date of 1 October. In addition trustees will be obliged to notify affected members on or before 1 August 2019.

Given the nature of Parliamentary procedure the Bill can still be amended and consequently the final version could contain different requirements and different deadlines.

At best, the current timelines will be virtually impossible for funds to satisfy; at worst they will have caused a significant amount of wasted effort if the Bill is amended.

Under the proposed timelines the Bill will also increase confusion arising from the PYSP changes that are still flowing through the system.

For example, members who were recently notified regarding the potential cancellation of their default insurance due to inactivity will need to be notified again due to their low balance. Given that an 'election' to guard against losing insurance due to inactivity does not apply to these measures this will have the potential to create confusion and frustration for members who are unlikely to understand why this needs to occur again. Over 24,000 HESTA members recently took action to ensure their insurance continued and many of these members will need to be notified again that they may lose their insurance.

We note that the recent changes had a short implementation period which created significant member confusion given there was very little time to develop and distribute member campaigns or direct communications. HESTA experienced significantly high numbers of members trying to contact our call centre in the short period before the changes took effect.

The recent updates required development of processes and systems to identify members, development of mechanisms to 'opt-in', drafting, testing, reviewing and distributing notifications to members – these processes require time to do properly. The measures will also require changes to documentation, such as Significant Event Notices, Product Disclosure Statements and other materials.

Account 'erosion'

The Bill aims to "*to protect individuals' retirement savings from erosion, ultimately increasing Australians' superannuation balances*."[11]

Given this we note the Productivity Commission's observation that "***Unintended multiple accounts (and particularly multiple insurance premiums) are the most egregious driver of balance erosion***."[12] We agree entirely and HESTA supported the inactive account consolidation measures that came into effect on 1 July 2019.

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[11] *Treasury Laws Amendment (Putting Members' Interests First) Bill 2019*- Explanatory Memorandum.

[12] Superannuation: Assessing Efficiency and Competitiveness -Productivity Commission (pg 293).

We strongly recommend that various measures to remove multiple accounts and consolidate inactive accounts should be given sufficient time to address these issues before pushing through more changes.

As a result of the upcoming consolidation of inactive balances to the ATO it is expected that up to $6 billion will make its way to a members' active account in the first year. This will increase balances in the active accounts of 3 million members.

The first transfer of inactive low balance accounts to the ATO must take place by 31 October 2019, and the second in 30 April 2020.

If the Bill is passed in its current form with a commencement date of 1 October, members with active accounts with balances of less than $6,000 will lose their insurance cover only to potentially have it reinstated if inactive account/s are consolidated with their active account.

This is highly confusing and adverse for members and could easily be avoided by extending the Bill's implementation date until after the first round of inactive account consolidation has occurred.

Conclusion

We make this submission as a super fund with a strict profit-to-members model, therefore making no material gain by the provision of insurance through a third party.

We feel passionately about this topic because our members, who overwhelmingly dedicate their working lives to the provision of care for others will be worse off if this Bill is passed in its current form.

Providing insurance through super, to all members regardless of age or balance, is an important central pillar of the retirement system.

We urge policy makers to consider the broad and dangerous ramifications of proceeding with this Bill, at the very least the passage of the legislation should allow for enough time to properly consider all the impacts.

HESTA recommends the "*Putting Member's Interests First" Bill* be removed from consideration by the Parliament.

Failing that, we submit that Trustees should have discretion to design insurance and have it provided to members in a default manner as they see fit.

Further, we submit that the timelines for consideration of the impacts and implementation are grossly inadequate. Should the Government consider passing this Bill, our members would require and that the implementation timeframe be extended to 1 March 2020.