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Submission to the Senate Economics Legislation Committee inquiry into the Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 [Provisions]

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Summary

We welcome the opportunity to make a submission to the Senate Economics Legislation Committee inquiry into the Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 [Provisions]. This submission draws on work by Grattan Institute on various aspects of superannuation.

The Bill should be passed at the earliest opportunity. It will stop millions of Australians paying for inappropriate income protection, life, and total & permanent disability (TPD) cover they don’t need, resulting in higher superannuation balances at retirement for many Australians.

The premise of the Bill is simple: defaults should be set so that they are appropriate for most people. The Bill would prevent trustees from providing opt-out insurance to new members younger than 25 and members with balances below $6,000 unless a member has directed otherwise, as recommended recently by the Productivity Commission. These changes would not be the best for everyone, but they would provide the greatest benefit to the most workers at the least cost.

Super industry demands for amendments to similar provisions in the earlier Protecting Your Super Bill should be rejected. These carve-outs to have automatic insurance cover start at age 22 instead of 25, and to require workers in high-risk industries to continue to be defaulted into life and disability insurance through super, would hurt vastly more people than they would help. These amendments would address problems for the small number of young or low-income people who do need such insurance, but at the cost of forcing millions more people to pay for insurance they don’t need, draining workers’ retirement savings by more than $300 million a year.

The Government should embrace the Productivity Commission’s recommendation for an independent public inquiry into insurance in superannuation. Such an inquiry should evaluate whether members get value for money for insurance offered through superannuation, whether insurance should continue to be offered on an opt-out basis in default MySuper products, and it should consider alternative approaches to providing default insurance cover outside of superannuation. That inquiry should also examine the duplication of insurance offered within superannuation with existing compulsory state-based workers’ compensation schemes.

1 Principles

The Bill would prevent trustees from providing opt-out insurance to new members younger than 25 years and members with balances below $6,000 unless a member has directed otherwise.

Common principles should be applied to thinking about these changes.

Defaults should be set so that they are appropriate for most people who do not make an active decision. Inevitably the default outcome will not be the best outcome for *every* person to whom it applies. But a default should be set to provide the greatest benefit at the least cost. Only in very rare circumstances would the benefits of setting the default in one direction for a smaller number of people outweigh the benefits of setting the default in the other direction for a larger number of people.

Of course, in theory community wellbeing could be maximised by setting more complex rules. But such an approach may conflict with the next principle.

Systems should trade-off optimal outcomes against lower complexity. More complex rules will often appear to result in more appropriate outcomes for a greater number of people. But 'kludgeocracy' – increasingly complex government rules – has hidden costs.[1] Complexity imposes additional costs on individuals, businesses and government administrators. It discourages innovation. More worryingly, complexity makes it easier for vested interests to extract rents by lobbying for rules that benefit them. The complexity and detail can obscure the impact to all but insiders, and exhaust the limited resources of those representing the public interest.

When these and other principles are taken into account, the reforms proposed in this Bill would substantially improve Australia's superannuation system.

[1] The term 'kludgeocracy' was coined and described in Teles (2012).

2 Insurance

The Bill proposes to change insurance in superannuation so that individuals are not 'defaulted in' to insurance if they are under 25 or have less than $6,000 in their superannuation account.

2.1 Hard defaults in insurance through superannuation

Defaults and options are not black and white. A default may be more or less obvious to a customer – who may therefore be more or less likely to exercise his or her own choice. Options can be easier or harder to exercise.

Under the current system, defaults are particularly likely to influence whether someone obtains insurance through superannuation. The default is triggered whenever a person obtains a new superannuation account – almost invariably when they begin a new job. At this point, they are relatively unlikely to focus on whether they want insurance.

Opting out of insurance through superannuation is relatively difficult for some members. Some funds do not allow members to opt out at the time that they are enrolled in the superannuation fund (when they start work) – instead they can only opt out only once the first superannuation contribution has been made, often several months later. Superannuation funds do little to highlight to members that they have an option to discontinue insurance. And the process of opting out can be difficult.[2]

The proposed changes would both leave many people out of insurance, and make the default insurance much more obvious and easier to decline. If members qualify for insurance only once they turn 25 and their balance exceeds $6,000, then most members will only be defaulted into insurance well after they have started to work. As a matter of practice, superannuation companies will have to notify members that they are being defaulted into insurance. Because this will not be at the time of enrolment in the superannuation fund, people are more likely to notice that they are acquiring insurance, and so more likely to consider whether they really want it. It is of course desirable to give people a product only if they think it is appropriate to their needs – unless the objective is to compel people to insure (in which case a compulsory system would be much more efficient).

2.2 No default insurance for under-25s

The Bill proposes that members under 25 would not be defaulted into insurance. They are likely to have lower incomes, and so insurance premiums are more likely to erode their superannuation balances. More importantly, they often don't need insurance. Often they don't even know they are insured.

Life insurance is unlikely to be appropriate for most under-25s, who are unlikely to have dependents. Younger workers are likely to receive less value from having insurance through their superannuation. Only 6 per cent of people aged 23-24 and in employment have a child.[3] If a 23-year-old dies, it is unlikely that

[2] Productivity Commission (2018a), pp.337-338.

[3] Grattan analysis of the ABS *Survey of Income and Housing 2015-16.*

any partner would depend on income support from their insurance for the rest of their lives.[4]

Of course there will be exceptions – but as discussed in section 1, defaults should be appropriate for the bulk of people affected rather than less likely cases. And members can continue to opt-in to insurance cover where they see the value in paying for it.

Amendments proposed by the super industry[5] to the earlier Protecting Your Super Bill, to have automatic insurance cover start at age 22 instead of 25, should not be incorporated into similar provisions in this Bill. These amendmenrts would address potential problems for a small number of young or low-income Australians, but at the cost of forcing millions more to pay for insurance they don't need. Our calculations show the proposed amendments would ensure about 43,000 young workers with dependent children or a mortgage would be insured. But another 550,000 young workers with neither would be defaulted into paying for insurance they didn't need, draining their retirement savings by $200 million a year.[6]

Income protection and TPD insurance can be more relevant to under-25s. But many people – particularly those on lower incomes, who are typically younger workers – might rationally prefer to rely on the social safety net of the Disability Pension in the unlikely event that they are unable to work as a result of an accident not related to employment. And in the meantime their superannuation balances would not be eroded.

[4] Australian Super has noted that only about 10 per cent of its claims from members aged under 25 have been paid to financially dependent partners and children. Productivity Commission (2018b), p.392.
[5] Industry Super Australia (2018), p.12.
[6] Coates (2019).

2.3 No default insurance for small balances

The Bill proposes that members with balances below $6,000 would not be defaulted into insurance.

Low-balance accounts comprise a significant proportion of the superannuation system and are at particular risk of erosion by fees and insurance premiums. As at 30 June 2016, there were about 9.5 million accounts with balances below $6,000. This is about 40 per cent of all accounts within the superannuation system. Of these low-balance accounts, more than 60 per cent (about 6 million accounts) had not received a contribution (or rollover) in the previous 13 months.[7]

There is concern that this provision in the Bill would lead to a substantial number of people with dependents being uninsured. But given the proposed legislation, in practice people over 25 are likely to have at least one superannuation account with more than $6,000. For someone on average earnings of about $45,000 a year, compulsory superannuation contributions will create a balance of more than $6,000 within a year-and-a-half. A person over 25 is likely to have no superannuation account with $6,000 only if they have multiple unconsolidated accounts. The current default regime would provide such a person with multiple insurances – probably involuntarily.[8] Consolidation of accounts, as required under the Protecting Your Super legislation, will reduce this risk – and also make it much more likely that someone over 25 will have at least one account with a balance of more than $6,000.

[7] Explanatory Memorandum, Putting Members' Interests First Bill 2019 (Cth), 16.
[8] For example, income protection insurance can typically be claimed against only one policy and only when members are working (Productivity Commission, p.21).

If default insurance commences only once an account reaches $6,000, rather than at the beginning of employment, it is more likely that an member will turn their mind to considering whether insurance is appropriate for them (see above section 2.1).

2.4 High-risk industries

There is concern that people working in higher-risk industries will struggle to obtain group insurance outside of superannuation.[9] If insurance is opt-in, insurers may be more wary of adverse selection, and insist on underwriting to assess an individual's risk more carefully.

But the primary need for insurance is typically for incapacity unrelated to work. It is no coincidence that the examples cited in debate on this issue typically involve illnesses or accidents unrelated to work. Workplace injuries are usually covered by workers' compensation schemes that typically pay benefits an order of magnitude larger than the amount paid under default superannuation insurance.

For example, if a person dies through a work-related accident in Victoria or NSW, their dependants receive compensation in the order of $650,000 to $800,000.[10] This is far more than they are likely to get from insurance through super, where the average benefit is just over $100,000.[11]

Nevertheless, insurance through superannuation typically covers both workplace injuries and incapacity unrelated to work, and so is much more costly for the insurer in higher-risk industries.

People in high-risk industries are also unlikely to have more illnesses or accidents outside of work. According to the Australian Institute of Health and Welfare, a 40-year-old is most likely to die from suicide, accidental poisoning, a car accident, or heart disease.[12] Work accidents are well down the list.

The problems could be easily remedied by writing insurance that did not cover incapacity covered by workers compensation. People in high-risk industries are unlikely to have more illnesses or accidents outside of work. It is unlikely that the problems of adverse selection in this situation would be any greater than for workers in low-risk industries.

Proposed amendments[13] to similar provisions in the Protecting Your Super legislation to insist that workers in high-risk industries continue to be defaulted into life and disability insurance through super, despite already being insured against accidents at work through workers' compensation, would have cost workers $115 million a year in unnecessary premiums.[14]

Instead, the Putting Members' Interests First Bill allows default insurance to continue for under-25s and people with low super balances where an employer makes additional superannuation

9 Industry Super Australia (2018).
10 For example see: Worksafe Victoria (2019); NSW State Insurance Regulatory Authority (2019).
11 From 2013 to 2016, the average benefit per claim was $124,657 in the event of death and $103,092 in the event of disability. KPMG (2017), Table 1.
12 Daley and Coates (2019).
13 Treasury Laws Amendment (Protecting Your Superannuation Package) Bill (Cth) 2018, cl.23(a).
14 Coates (2019); Grattan analysis of Industry Super Australia (2018), Table 4, and Productivity Commission (2018b), p.296.

contributions that cover the full cost of the workers' insurance premiums.

And the Government should proceed with the Productivity Commission's recommendation for an independent public inquiry into insurance in superannuation. That inquiry should also examine duplication of insurance offered within superannuation with existing compulsory state-based workers' compensation schemes.

2.5 Implementation

The Bill is scheduled to take effect from 1 October 2019, with trustees required to give affected members written notice before 1 August 2019 providing them the opportunity to elect to retain their insurance cover. This timeline appears overly optimistic.

Yet the industry should not be allowed to drag its feet in implementing these reforms. Lengthy delays would result in super fund members continuing to pay for inappropriate insurance cover they don't need, resulting in further erosion of superannuation balances for many Australians.

Previous changes to default insurance in superannuation, such as the introduction of default insurance within superannuation as part of the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act, came into force seven months after the Bill's passage.[15] Similarly, it took the industry five months to implement provisions of the Protecting Your Super Legislation that received Royal Assent on 12 March 2019 and took effect on 1 July 2019.

Therefore a 1 December 2019 start date may be an appropriate, with trustees required to notify affected members by 1 September 2019.

[15] Evidence from John Daley to the Senate Economics Legislation Committee Inquiry into the Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 on 20 July 2018.

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