Productivity Commission Report

MetLife Client Update

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MetLife client update

MetLife is pleased to bring you an update of the Productivity Commission's work on the superannuation system.

On 29 May 2018, the Commission issued its Draft report on Stage 3 of the project on Superannuation: Assessing Efficiency and Competitiveness. This process has consisted of three phases:

1 Development of a framework to assess efficiency and competitiveness in the super system

2 Development of a set of alternative models for allocating default members to products

3 An inquiry which assessed the efficiency and competitiveness of the super system, drawing on the work in stages 1 and 2

The Draft Report is open to consultation until 13 July 2018 and is available on the Commission's website: http://www.pc.gov.au/inquiries/current/superannuation/assessment/draft

The due date for the final report has not yet been announced but is likely to be later this year.

The Draft Report identifies two significant structural flaws in the system:

1. unintended multiple accounts; and
2. entrenched underperformance.

The Commission also found that not all members get value out of insurance in super. Many see their retirement balances eroded, often by over $50,000, by duplicate or unsuitable insurance policies.

In terms of insurance in super, the most significant recommendations for trustees are:

- **Default members:** Introduction of a new system for allocating default members by means of employee choice from a shortlist of 'best in show' funds, to be compiled by a new independent body. If members don't make a choice, they will be sequentially allocated from the shortlist, that is, allocated randomly. Members would only be defaulted once, when they first enter the work-force;
- **Changes to insurance:** the Commission recommends that new members under 25 only get insurance on an opt-in basis and that insurance should cease if an account is inactive for 13 months. These recommendations have already been announced as part of the Government's Protecting Your Super package.

Member outcomes of the current system

The Commission's Draft Report outlines the following member outcomes arising from the current system:

- **Underperformance.** The super system has delivered mixed returns with some funds underperforming over the long-term. This can have a significant effect on retirement savings. Most (but not all) underperforming products are in the retail segment. The Commission opined that MySuper returns can be a lottery for default members.
- **Fees are a drain on net return.** Fees have come down over the last few years, particularly in retail products, but remain a drain on net returns. Reported fees in Australia are higher than in many other OECD countries. Funds were criticised for not providing granular data on investment option fees and performance to the Commission.
- **There are too many multiple accounts.** There are about 10 million multiple accounts. Unintended multiple accounts collectively cost members $1.9 b in excess insurance premiums and $690m in excess administration fees.
- **There are too many products.** Members face a bewildering number of products to choose from, especially in the choice sector. Many members find the super system is too hard to navigate and do not know where to turn to help.
- **Insurance is not delivering value for all members.** About 12 million Australians have insurance through super and in 2016-17 paid a total of $9b in premiums. But up to 25% of members do not know that they have a policy and are paying for it. The Commission acknowledges that group insurance makes it more affordable for members than individual insurance. However, because most policies are provided on an opt-out basis, the large share of low-risk members in the pool acts to keep premiums down for everyone. According to the Commission, group insurance does not represent good value for all members. The effects are regressive, that is, worse for members on low incomes especially those with intermittent work patterns. Some insurance is unnecessary – about 17% of members have duplicate policies and some members are defaulted into policies they can't claim on ('zombie' policies). The main culprit of zombie policies is income protection. The Commission also commented on other questionable practices within insurance in super including these mentioned to the right.

Extremely complex and incomparable policies

Member difficulties in interacting with funds

The bundling of death and disability insurance meaning that members can't opt out of life cover while keeping their disability cover

Poor application of risk premiums for example for occupation or smoking status

Inadequate tailoring of policies for different cohorts

What are the drivers of poor member outcomes?

The Commission has identified the following drivers of mixed performance across the system:

- Members do not always make good decisions. The system and Government have made engagement harder than it should be. Complexity of products, frequent tax changes and lack of simple information have made it hard for members to engage.
- There is some competition in the industry, but it's not always healthy. Particularly in the retail sector, a sign of unhealthy competition is the proliferation of tailored products. Another sign is the number of sub-scale and underperforming funds still in the industry.
- Default allocation is not putting members first. The modern award system is ineffective, as the Fair Work Commission is not currently operating as intended, and in any event does not have processes for reviewing and delisting underperforming funds. A more fundamental modernisation is needed.
- Governance falls short of best practice. Good practice would dictate that the trustee board of all funds have a requisite mix of knowledge, skills and experience and are free from potential conflicts of interest.
  The Commission pointed to mergers which have been broached but not completed as a symptom of poor governance.
- Regulators need to focus more on member outcomes. The PC was critical of both APRA and ASIC for not focusing on 'strategic conduct regulation' that is identifying and regulating actual or potential instances of member harm.
- There are yawning gaps in data. The Commission was critical of data gaps and of the fact that many funds provide incomplete responses to the surveys it sent out last year and some had not responded at all.

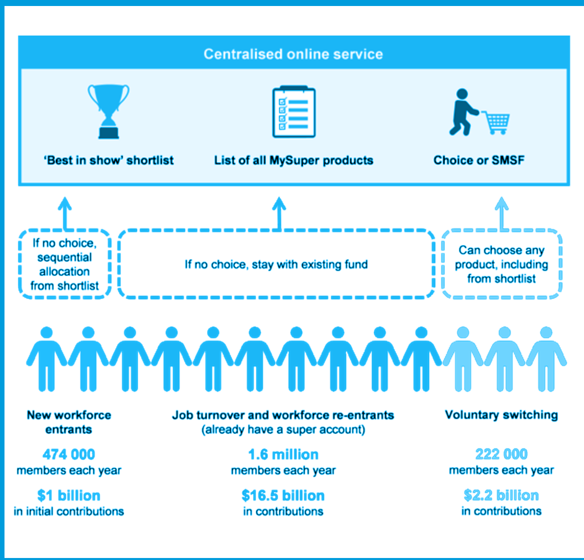
The Commission commented that recent reforms have chipped away at these issues but more fundamental reform and modernisation is needed.

Recommendations

The Commission has proposed a range of improvements to modernise the system and benefit members, including:

- **A new mechanism for allocating defaults.** A new independent expert panel would be appointed and charged with compiling a shortlist of 'best in show' products for all members. Members would be encouraged to choose their own product from the shortlist when they enter the workforce and would not be defaulted into another fund. If a member does not choose a fund within 60 days, they would be sequentially allocated to a product from the shortlist. This is similar to the 'assisted employee choice' model for default super proposed in the Commission's Stage 2 inquiry. The process of choosing a fund would be made easier by the ATO developing a centralised online service in myGov. The diagram below shows how members would be allocated. Additionally, the ATO should more proactively clean up multiple accounts.

Figure 13 from the Draft Report



- Insurance that works for members. Insurance should be made opt-in for members under aged 25 years and insurance cover should cease on accounts that have had not contributions for 13 months. Trustees should be required to articulate and quantify the balance erosion trade-offs they have made for their members and to publicise this on their websites.

- An elevated test for MySuper. The Government should legislate to empower APRA to enforce the member outcomes test. The outcomes test for MySuper should be further bolstered by a requirement for independent verification at audit-level standard at every 3 years. Funds should also be required to adopt the Insurance in Super Code as part of MySuper authorisation.

- Products and information that meet members' needs. Simpler, clearer and more widely applied dashboards are needed. Data should be better harnessed to design super and insurance products. Some egregious practices should be stamped out, including employer non-compliance with SG obligations, grandfathered trail commissions and exit fees.

- Best practice governance. The Commission contended that best practice would be to have at least one third of independent directors and recommended that the Government amend legislation which restricts the appointment of independent directors. The Commission recommended that mergers should be facilitated by regulators and potential mergers notified to APRA.

- Regulators should become member champions. There should be better clarity between the roles of APRA and ASIC and regulators should collect more data relevant to assessing member outcomes.

More work to be done on insurance

The Commission stated that existing estimates of the fiscal benefits of insurance overestimate the net fiscal impact as they do not model the impact of balance erosion on Age Pension eligibility.

The Commission will soon be publishing further analysis on the fiscal effects of insurance in super.

It has also asked for submissions that address the following questions about insurance:

- What is the case for bundling life and TPD insurance? Are there funds that offer them separately and if so how many members have elected to have only one type of cover?
- What is the value of money case for IP insurance being provided on an opt-out basis in MySuper?

Industry reaction

Industry Super Australia has welcomed the report saying that the jury is in and this proves that industry funds do perform better than retail funds.

However, it expressed caution about the proposal for a new body to select default funds, and argues against dismantling the Fair Work Commission process.

The Financial Services Council has welcomed the report, as it has long argued that super should be de-coupled from the industrial system. It has however expressed caution about the composition of the independent panel.

The Australian Super Funds Association (ASFA) has issued a guarded press release saying that any reforms should not disrupt the world class Australian system and that diversity in super funds means that products can be tailored to members' needs. Dr Martin Fahy, ASFA Chief Executive, has also expressed concern about the collateral damage to funds that are performing above benchmark but who would be cut off from accepting default members.

Next steps

Following the consultation process, the Commission will issue its final report. A date for this has not yet been announced.

After the final report, the Government will have to consider the Commission's recommendations and determine whether to accept them. The Government has already adopted some of the Commission's recommendations as part of its Protecting Your Super package, as below.

- providing insurance on an opt-in basis to new members under age 25

- cancellation of insurance following contribution inactivity of 13 months

- More proactive cleaning up of multiple accounts by the ATO

MetLife is considering the potential impacts of the proposed default model on insurance design and pricing and would be happy to meet with you to discuss the Draft Report further.

About MetLife in Australia

MetLife is a leading provider of life insurance, partnering with employers and super funds to help more Australians create a lifestyle they love – and providing help when they need it most.

Our 150-year history and global presence gives us the scale and experience to be a valued and trusted partner in business. We protect customers in more than 40 countries worldwide, and lead the market in corporate insurance solutions in the US, Asia, Latin America, Europe and the Middle East.

MetLife is the third largest group insurer in Australia, protecting more than 2.6 million people. We support our claimants to get back on their feet financially, having disbursed approximately $485 million in claims in 2017, and we provide an exceptional claims experience with access to ancillary support services to promote holistic health and wellbeing.

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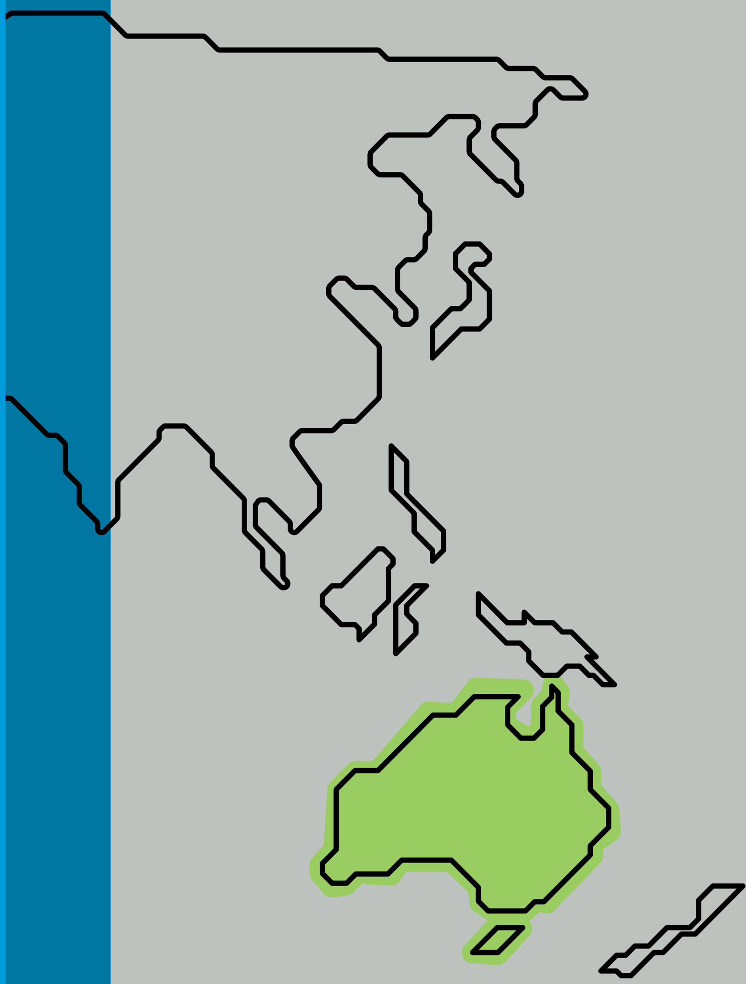

Please contact your Relationship Manager to organise a discussion around the impacts and how MetLife can support your business.

Thank you.

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